FILED
OCT 25 1961
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1961.

No. 516

BORNE CHEMICAL COMPANY, INC., THOMAS E. BETNER, WILLIAM L. LESS, THOMAS A. MARINO, THE CEM SECURITIES CORPORATION, WALTER L. McMANUS, MARSHALL A. JACOBS, GEORGE E. ALLEN, CLYDE E. WILLIAMS, HENRY E. BRANDLI and H. EARL NORTHRUP,

Petitioners,

v.

CHARLES A. McCLURE and RUTH E. McCLURE,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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Petitioners,

v.

CHARLES A. McCLURE AND RUTH E. McCLURE,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioners pray that a writ of certiorari issue to review the judgment of the Court of Appeals for the Third Circuit entered on July 5, 1961, a timely filed petition for rehearing being denied on September 19, 1961.

CITATIONS TO OPINIONS BELOW.

The opinion of the District Court, printed as an appendix to this petition (1a), is not reported. The opinion of the Court of Appeals for the Third Circuit is reported at 292 F. 2d 824 (3rd Cir., 1961), and is printed as an appendix to this petition (6a et seq.).

JURISDICTION.

The judgment of the Court of Appeals for the Third Circuit was entered on July 5, 1961, and a timely filed petition for rehearing was denied on September 19, 1961. This Court's jurisdiction is invoked under 28 U. S. C. §§ 1254(1), 2101(c).[1]

QUESTIONS PRESENTED.

Respondents, owning less than 1% of the stock of petitioner, Borne Chemical Co., Inc., a New Jersey corporation, with its principal office in New Jersey (hereinafter referred to as "Borne"), instituted a derivative action in the Federal District Court for the Eastern District of Pennsylvania. The defendants therein were Borne, its directors and the CEM Securities Corporation, Inc., an unrelated corporation (hereinafter referred to as "CEM").

The corporate cause of action sought to be enforced **derivatively** by the respondent shareholders consists of alleged violations of state-created fiduciary obligations. Respondents allege that because Borne did not inform its shareholders of such facts in a proxy statement issued in connection with the sale of stock, such sale allegedly violated Section 10(b) of the Securities Exchange Act of 1934, and Rule X-10B-5 adopted thereunder by the Securities and Exchange Commission. This section (as implemented by the supporting Rule) is solely a criminal statute which neither expressly nor impliedly provides for civil suits by persons injured as a result of a violation thereof.

Consequently, neither Section 10(b) nor Rule X-10B-5 makes any provision for the procedures which must be followed and the necessary requirements which must be met

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1. The District Court's order denying petitioners' motion for security for costs is an appealable order. *Cohen v. Beneficial Industrial Loan Corp.*, 337 U. S. 541; *Knapp v. Bankers Securities Corporation*, 230 F. 2d 717 (3rd Cir. 1956).

before a private cause of action may be pursued. And there is no provision either in Section 10(b) or in Rule X-10B-5 permitting a shareholder to enforce a corporation's right of action. In short, Congress has been completely silent both as to the existence of, and the prerequisites for bringing, private civil actions under Section 10(b) and Rule X-10B-5.

New Jersey, the State of Borne's incorporation, has set forth certain requirements which must be met by a stockholder before he will be permitted to seek to enforce **any** (domestic, foreign or federal) cause of action on behalf of his corporation. Such corporate law provides that in "**any** action" instituted or maintained in the right of any domestic corporation, the corporation is entitled to have any derivative plaintiff holding less than 5% of the par value of the outstanding shares of the corporation, unless the market value of his shares is in excess of $50,000, post security for the reasonable expenses, including counsel fees, which may be incurred in the litigation by it and by the other parties defendant who it would be obligated to reimburse.[2]

Pursuant to another section of the New Jersey corporate law,[3] Borne has provided in its by-laws that it must indemnify its officers or directors against reasonable costs, expenses and counsel fees incurred in connection with any action, suit or proceeding to which any such director may be made a party by reason of his being such director. It is protection from this liability which the New Jersey Legislature sought to provide for in its corporate law providing for security for costs.[4]

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2. Laws of New Jersey, 1945, c. 131, p. 487, § 1; N. J. S. A. 14:3-15.

3. Laws of New Jersey, 1942, c. 124, p. 408, § 1; N. J. S. A. 14:3-14.

4. The corporate law of the forum, the Commonwealth of Pennsylvania, is virtually identical. Pennsylvania Act of April 18, 1945, P. L. 253, No. 114 § 2, 12 Purd. Stat. § 1322.

Under such circumstances, the question presented is:

1. Where a New Jersey corporation is given a right to security for expenses, including counsel fees, both by the law of its State of incorporation and by the law of the forum, in **"any"** derivative action, is such right abrogated and the corporation deprived of security merely because the corporate cause of action which is sought to be enforced derivatively is alleged to be based upon the violation of a federal criminal statute which federal statute neither expressly nor impliedly confers a private civil right of action on the corporation and neither expressly nor impliedly determines whether and under what circumstances a shareholder can enforce a corporate right in a derivative action?[5]

STATUTORY PROVISIONS INVOKED.

The statutes involved are: (1) Rules of Decision Act, 28 U. S. C. § 1652; (2) Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j, and Rule X-10B-5 promulgated thereunder by the Securities and Exchange Commission, 17 Code of Federal Regulations, 240.10(b)-5; (3) N. J. S. A. 14:3-15; and 12 **Purd. Stat.** § 1322.

The Rules of Decision Act provides as follows:

> "The laws of the several states except, where the Constitution or treaties of the United States or Acts of Congress otherwise **require or provide**, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply." June 25, 1948, c. 646, 62 Stat. 944. (Boldface supplied.)

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5. Petitioners also wish to preserve for review another question which was raised before the Third Circuit but not discussed in its opinion. The question is: Are the petitioners entitled to security for costs, including counsel fees, under Section 11(e) of the Securities Act of 1933, 15 U. S. C. § 77K(e), where respondents in their Complaint alleged violations of Section 5 of that Act and asked for relief thereunder?

The New Jersey Statute provides:

"In **any** action instituted or maintained in the right of any domestic . . . corporation by the . . . holders of shares . . . of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares . . . held by such . . . holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive." L. 1945, c. 131, p. 487, § 1; N. J. S. A. 14:3-15.

The Pennsylvania Act has virtually the same provision, 12 **Purd. Stat.** § 1322.

Also involved is the **criminal** provision of Section 10(b) of the Securities Exchange Act of 1934 as implemented by Securities and Exchange Commission Rule X-10B-5, which provide as follows:

Section 10(b):

"It shall be **unlawful** for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

. . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." June 6, 1934, c. 404, § 10, 48 Stat. 891; 15 U. S. C. § 78j.

Rule X-10B-5:

"It shall be **unlawful** for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

in connection with the purchase or sale of any security." (Boldface supplied.)

STATEMENT OF THE CASE.

Respondents, who own less than 1% of the stock of Borne, a New Jersey corporation and the principal petitioner herein, instituted a derivative action in the Federal District Court for the Eastern District of Pennsylvania against Borne, its directors, and CEM, an unrelated corporation.

The complaint alleged that on November 25, 1959 Borne entered into an agreement to sell 10,000 shares of its authorized and unissued common stock to CEM at the price of $22.00 per share, which was the price at which said stock closed on the American Stock Exchange on the date on which the agreement of sale was executed. As part of the sale, CEM gave an investment letter restricting CEM's right of sale, and, therefore, registration was not required.

It was then alleged that the directors of Borne called a special meeting of shareholders for December 2, 1959 to eliminate the preemptive rights of shareholders as then provided for in the corporate by-laws, pursuant to New Jersey statute. The meeting was held, and the by-laws were amended to eliminate the preemptive rights, with 745,473 shares voting in favor and only 13,570 shares voting against such amendment.

Respondents made two complaints to upset the vote and the sale. First, they alleged that the sale was unfair to Borne, since between November 25, 1959, the date of the agreement of sale, and December 16, 1959, the date of commencement of suit, the market price of the stock had increased, and that such increase was due to manipulative and deceptive activities by the petitioners.

Second, they claimed that petitioners violated their state-imposed fiduciary duties in that they did not get the best price for the stock, they refused to permit respondents to examine the stock books, and they did not properly conduct the vote on the preemptive rights question. It is then

alleged that since the proxy statement [6] used did not inform the stockholders of such breaches of fiduciary duties, it was misleading. For these two reasons it is alleged that the sale violated Section 10(b) of the Securities Exchange Act.

In their complaint, respondents also alleged that since the officers of Borne had acted in conspiracy with CEM and its majority shareholders, it was unlikely that Borne would pursue its corporate cause of action, and, therefore, respondents, as shareholders, should be permitted to bring such action as a derivative shareholders suit on behalf of Borne.

Borne and the other petitioners herein, prior to answer, filed a petition for security for costs, including counsel fees. The District Court denied petitioners' motion on the ground that where the pleadings claim that the corporate cause of action was based upon violation of a federal criminal statute, the State statute with respect to security for costs in a derivative action cannot be applied.

An appeal was taken to the Court of Appeals for the Third Circuit. Petitioners' arguments in support of their right to security for costs, as summarized by the Third Circuit, included:

> "First, it is contended that State law determines whether a plaintiff may be required to post security and that since both Pennsylvania, the State in which the court below sits and New Jersey, the State of incorporation and principal place of business of Borne Chemical Company, have security-for-expenses statutes, the defendants are entitled to the posting of security. Second, it is argued that under 'general federal equity law' plaintiffs such as those at bar who bring derivative suits may be required to post security for expenses

6. Borne, since it was listed on the American Stock Exchange prior to 1933, is not required to comply with the proxy rules promulgated by the Securities and Exchange Commission. But respondents argued that nevertheless those rules should establish the common law standard of disclosure, even for corporations not covered by such Commission proxy rules.

and that, therefore, even if State law be inapplicable the defendants are entitled to security. Third, the defendants assert that a security for expenses provision should be implied from Section 10(b) of the Securities and Exchange Act of 1934 by analogy to other provisions of the Securities Acts which couple security for expenses provisions with provisions granting private rights of action." (10a)

Petitioners also argued, although it is not mentioned in the opinion of the Third Circuit, that they were entitled to security for costs, including counsel fees, under Section 11(e) of the Securities Act of 1933, which expressly provides for security for costs, since the complaint alleged a violation of, and asked for relief under, Section 5 of the Securities Act of 1933.

The court below affirmed the order of the District Court denying security. It rejected the application of the Pennsylvania statute on the ground that the *Erie* doctrine does not apply in a non-diversity action. The court, however, stated that "the question whether the New Jersey, the state of incorporation, security-for-expenses statute applies poses a subtler problem," (17a). But it, nevertheless, rejected petitioners' arguments by citing a case which refused to apply the security-for-costs statute of the **forum**—not the place of incorporation—because of the non-applicability of the *Erie* doctrine to non-diversity cases.[7] The foregoing judgment of the Court of Appeals for the Third Circuit is the order which petitioners here seek to review by writ of certiorari.

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7. *Fielding v. Allen*, 181 F. 2d 163, *cert. denied, sub nom. Ogden Corporation v. Fielding*, 340 U. S. 817.

REASONS FOR GRANTING THE WRIT OF CERTIORARI.

Preliminary Statement.

The question presented herein has nothing whatsoever to do with the part of the *Erie* doctrine dealing with diversity jurisdiction. Rather, the question presented for consideration is what law is to be applied by the federal courts in a shareholder's derivative action in a case in which the statute from which the federal right is allegedly based is silent as to the prerequisites for bringing such an action, and whether a private cause of action exists at all.

I.

The Decision Below Conflicts With the Applicable Decisions of This Court Dealing With the Law to Be Applied to Determine Corporate Shareholders' Rights Inter Sesse and Remedies Where the Federal Statute Is Absolutely Silent on the Subject.

Section 10(b) of the Securities Exchange Act of 1934 is a criminal statute. It neither expressly nor impliedly provides for civil suits by persons injured as a result thereof. Congress thus necessarily has been silent as to who may bring such an action and under what conditions.

To fill the gap in such situations, Congress in the Rules of Decision Act, 28 U. S. C. § 1652, provided:

> "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

This Court repeatedly has held in situations similar to the one presented herein that a federal court should apply State law, even in a suit to enforce express civil provisions of a federal statute where the precise issue is not expressly covered by the federal statute conferring the basic right. *De Sylva v. Ballentine*, 351 U. S. 570, 580;

O'Sullivan v. Felix, 233 U. S. 318; *Campbell v. City of Haverhill*, 155 U. S. 610. This principle was applied in *Hooper v. Mountain States Securities Corporation*, 282 F. 2d 195, 205 (5th Cir., 1960), *cert. denied*, 5 L. Ed. 2d 693 (1961), wherein the court held that since Section 10(b) of the Securities Exchange Act of 1934 made no provision for a statute of limitations, the federal court should apply the statute of limitations of the State in which it was sitting.[8]

More particularly, the decisions of this Court uniformly recognize that corporations are artificial creations of State laws and that all relations between the stockholders and their corporation are governed by State law, except where the Constitution or treaties of the United States or Acts of Congress otherwise expressly provide. In the absence of federal incorporation there is no doubt but that the issue of whether a person is a stockholder in a domestic corporation, and has standing to enforce either his own or the corporation's rights, is governed by the law of the State of incorporation even in proceedings in federal courts, to enforce rights expressly conferred by federal statutes. *Price v. Gurney*, 324 U. S. 100. (Whether certain shareholders could act for corporations in filing a petition under Chapter 10 of the Bankruptcy Act is to be determined by the law of the State of incorporation.)[9]

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8. See also *Tobacco and Allied Stocks v. Transamerica Corp.*, 143 F. Supp. 323 (D. Dela., 1956), *affirmed*, 244 F. 2d 902 (3rd Cir., 1957); *Pratt v. Robinson*, 203 F. 2d 627, 634 (9th Cir., 1953), cf. *Gordon v. Loew's, Inc.*, 247 F. 2d 451, 454 (3rd Cir., 1957), wherein the court stated that at a time when there was no federal statute of limitations applicable to suits under the federal anti-trust laws, the statute of limitations of the State in which the district court was sitting was applied by that court to litigation arising thereunder. See also *Smith's Estate v. C. I. R.*, 292 F. 2d 478 (3rd Cir., 1961). (New Jersey law determines effect of dividend declaration even in a federal income tax case); *United States v. Merchants Nat. Trust & Savings Bank*, 101 F. 2d 399 (9th Cir., 1939). (Transfer of corporate stock determined by State law even in a federal income tax case).

9. See also: *Chicago T. & T. Co. v. Forty-One Thirty-Six Wilcox Building Corp.*, 302 U. S. 120 (status of shareholder in a dissolved corporation in federal bankruptcy proceedings to be deter-

This Court has often recognized the plenary regulatory powers which a State necessarily must have over the internal relations between a corporation created pursuant to its laws and the stockholders thereof.

In *Cohen v. Beneficial Industrial Loan Corporation*, 337 U. S. 541, 548, at pp. 549, 550, this Court has considered the extensive power which a State must have over stockholders' derivative suits:

> "The very nature of a stockholders' derivative action makes it one in the regulation of which the legislature of a state has wide powers. Whatever theory one may hold as to the nature of the corporate entity, **it remains a wholly artificial creation whose internal relations between management and stockholders are dependent upon state law and may be subject to most complete and penetrating regulation,** either by public authority or by some form of stockholder action. . . .
>
> ". . . A stockholder who brings suit on a cause of action derived from the corporation assumes a position, not technically as a trustee perhaps, but one of a fiduciary character. He sues not for himself alone, but as a representative of a class comprising all who are similarly situated. The interests of all in the redress of the wrongs are taken into his hands, dependent upon his diligence, wisdom and integrity. And while the stockholders have chosen the corporate director or manager, they have no such election as to a plaintiff who steps forward to represent them. He is a self-chosen representative and a volunteer champion. The Federal Constitution does not oblige the State to place

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mined by law of the State of incorporation): *Maxwell v. Enterprise Wall Paper Mfg. Co.*, 131 F. 2d 400 (3rd Cir., 1942) (standing of shareholder to force corporate receivership determined by law of State of incorporation); *Gordon v. Loew's, Inc.*, 147 F. Supp. 398, 402-408 (D. N. J., 1956), *affirmed*, 247 F. 2d 451 (3rd Cir., 1957) (status of shareholder in a dissolved corporation which seeks to enforce rights under Clayton Act is determined by law of State of incorporation).

its litigating and adjudicating processes at the disposal of such a representative, at least without imposing standards of responsibility, liability and accountability which it considers will protect the interests he elects himself to represent . . . **We conclude that the state has plenary power over this type of litigation.**" (Boldface supplied.)

Thus it is clear that State law must be determinative of those aspects of a shareholder's right which are not specifically spelled out in the federal statute creating that right. Although Congress has been silent with respect to the existence of a private cause of action under Section 10(b) and the prerequisites for bringing such an action, if such cause of action does in fact exist, both New Jersey, the State of incorporation and principal place of business of Borne, and Pennsylvania, the forum State, have security for expenses statutes.[10] It is clear that New Jersey intended this statute to apply to New Jersey corporations even though the wrong complained of arose under the law of a foreign State or under federal law. *Cf. Henis v. Compania Agricola De Guatemala*, 116 F. Supp. 223 (D. Dela., 1953), *affirmed*, 210 F. 2d 950 (3rd Cir., 1954). These State law requirements must be followed, not only because the federal rule is that State law determines those parts of a federal cause of action not covered by the federal statute when dealing with corporate shareholder standing matters, but also because otherwise, contrary to the holding of this Court in *Board of County Commissioners v. United States*, 308 U. S. 343, the beneficiaries of federal rights conferred by federal statute will enjoy a privileged or preferred position, even in the absence of explicit legislative policy cutting across State interests. This Court has not passed upon the applicability of state security-for-cost corporate statutes to causes of action implied from a federal criminal statute, but all cases indicate that such issue would be resolved contrary to the decision of the court below.

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10. N. J. S. A. 14:3-15; 12 Purd. Stat. § 1322.

The court below rejected the reasoning of the foregoing authorities on two grounds:

> (1) Since federal courts have traditionally recognized the right of a shareholder to vindicate federal rights of a corporation by a derivative shareholder's suit, State law can be ignored in ascertaining whether a particular shareholder is eligible to pursue the corporate right on behalf of the corporation; and
>
> (2) The Securities and Exchange Act of 1934 had as its purpose the creation of a federal law of management—stockholder relations and this should not be subordinated to limitations "such as security for expenses statutes reflecting State policy in the same area." [11]

The first argument clearly has been rejected by this Court in *Cohen v. Beneficial Industrial Loan Corp., supra,* and, further, is refuted by all of the above cited cases which hold that a federal court will apply state law, even in a suit based upon a federal right, where the precise question is not expressly covered by the federal statute conferring the basic right.

The second argument, that Section 10(b) and Section 29(b) of the Securities and Exchange Act of 1934 were intended to create a new federal law of management—stockholder relations, also is erroneous. There simply is no legislative language or history which supports the court's statement of Congressional intent, and the opinion refers to none. In Section 10(b), Congress clearly was not thinking about "management—stockholder relations." That section provides only that a sale of securities by the use of false

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11. The decision of the court below rested in part upon the fact that only a minority of the States have security-for-costs statutes. However, such statutes presently exist in New York, *New York General Corporation Law*, § 61-b; New Jersey, *N. J. S. A.* 14:3-15; Pennsylvania, 12 *Purd. Stat.*, § 1322; Maryland, Rule 328, *Maryland Rules of Procedure;* California, *Cal. Corp. Code*, § 834; and Wisconsin, *Wis. Stat.* § 180.405(4), which, with the exception of Delaware, constitute all of the important business states in the United States.

statements is a federal crime. There is not one word in Section 10(b) which deals with management—stockholder relations.

The New Jersey and Pennsylvania statutes do not conflict with the express language of Section 10(b) since the federal statute does not contemplate a private civil cause of action. Thus, Congress never dealt with the question whether a shareholder had to post security for costs, including counsel fees, in connection with a private suit under Section 10(b) of the Act, simply because Congress never dealt with the question whether Section 10(b) provided a private remedy. Such private remedy is afforded not by the express or implied terms of Section 10(b), but only due to the general common law doctrine which provides for civil liability arising out of the violation of a criminal statute. *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E. D. Pa., 1946).

To further demonstrate that the imposition of a security for expenses requirement upon a plaintiff in a shareholder's derivative action seeking to enforce a right arising under Section 10(b) would not conflict with the Congressional purpose motivating the adoption of Section 10(b), it should be noted that in most of the sections of the Securities Exchange Act of 1934 in which Congress expressly provided for a private right of action, it also expressly provided for a statute of limitations and security for costs.[12] This would indicate that Congress considered that a private right of action, a statute of limitations, and a provision for security for costs, all constituted a single "package" under the Securities Exchange Act of 1934.

Judge Hand's opinion in *Birnbaum v. Newport Steel Corp.*, 193 F. 2d 461, 463 (2nd Cir., 1952), *cert. denied*, 343 U. S. 956, clearly demonstrates that the imposition of a security for costs prerequisite would not conflict with the policy motivating the promulgation of Rule X-10B-5. Therein Judge Hand stated that the meaning and scope of

12. See, *e.g.*, 15 U. S. C. §§ 78i, 78r.

Rule X-10B-5 is not difficult to ascertain. Prior to its adoption, commented Judge Hand, no prohibition existed against fraud on a seller of securities by the purchaser if the latter was not a broker or a dealer. Rule X-10B-5 was adopted only to close this loophole and to prohibit individuals or companies from buying securities if they engage in fraud in their purchase. At page 463, Judge Hand wrote:

> "The SEC's press release, above quoted, which announced the Commission's adoption of Rule X-10B-5, shows that **the Commission was attempting only to make the same prohibitions contained in Section 17(a) of the 1933 Act applicable to purchasers as well as to sellers.** That such was the **only purpose** of Rule X-10B-5 is made abundantly clear when the language of the Rule is compared with the language of Section 17(a); the Commission simply copied Section 17(a) adding the words 'any person' in place of 'the purchaser' and a final clause 'in connection with the purchase or sale of any security.'" (Boldface supplied.)

Thus, the only purpose of Rule X-10B-5 was to make the same prohibitions contained in Section 17(a) of the Securities Act of 1933 applicable to purchasers as well as to sellers. Section 17(a) of the 1933 Act is one of the sections of the sub-chapter containing Section 11(e) of the Securities Act of 1933, "Domestic Securities." Section 11(e) contains a security for costs provision applicable "in any suit under this or any other section of this sub-chapter." Consequently, an action brought under Section 17(a) is subject to the security for costs provision of Section 11(e). The Acts of 1933 and 1934 are "unquestionably in pari materia and must be construed together to make a consistent whole." *Rosenberg v. Globe Aircraft Corporation*, 80 F. Supp. 123, 124 (E. D. Pa., 1948). Thus, it would be manifestly unfair to conclude that the imposition of a security for costs prerequisite on an action brought pursuant to Section 10(b) of the 1934 Act and Rule X-10B-5 pro-

mulgated thereunder would be contrary to the purpose of Congress, while the imposition of such a prerequisite on an action brought pursuant to the virtually identical Section 17(a) of the 1933 Act would not be contrary to the purpose of Congress. It also has been held that the New Jersey security for expenses statute in no way conflicts with the letter or policy of Rule 23 of the Federal Rules of Civil Procedure dealing with a plaintiff's right to maintain a shareholder's derivative action in a federal court. *Cohen v. Beneficial Industrial Loan Corp.*, 337 U. S. 541, 548.

II.

The Decision of the Court Below Conflicts With a Recent Decision of the Seventh Circuit.

The court below has held that in dealing with the Securities Exchange Act, a federal court fashions its own federal common law and rejects the law of the state of incorporation and the forum in determining those parts of the cause of action which are not expressly or impliedly spelled out in such federal statute. This is in direct conflict with *Bankers Life and Casualty Co. v. Bellanca Corporation*, 288 F. 2d 784 (7th Cir., 1961), *cert. denied*, — U. S. — (Oct. 9, 1961) in which the court held that since Section 29(b) of the Securities and Exchange Act contained no express provision dealing with the rights of a purchaser, federal courts should measure such rights in accordance with the law of the jurisdiction involved and not attempt to fashion a uniform federal rule. The court wrote at p. 787:

> "Whether the seller's rights under the contract have been voided by § 78cc(b), or have become unenforceable because of its breach of the contract, the rights of the purchaser are to be measured by the law of the jurisdiction involved. Here the contract was made in Illinois. Bankers' election to retain the shares delivered was made in Illinois. The law of Illinois governs."

III.

The Public Importance of the Issues Presented.

Lower federal courts recently have developed law to the effect that persons injured as the result of a violation of the criminal provisions of the various federal securities acts may seek private recovery in a federal court even though there is nothing in a particular act to indicate that Congress intended such relief. One such case is now before this Court for argument this Term. *Management Funds, Inc. v. Brouk,* October Term, 1961, No. 87.

This development requires the federal courts to fill in the gaps created by Congressional silence. Thus, such questions as the appropriate statute of limitations to be applied, the effect of a void contract, and who can enforce such rights, will have to be worked out by reference to State law or, in the alternative, a new body of federal common law will have to be developed.

All of the large industrial States except Delaware have now enacted security-for-expenses statutes to protect a corporation against derivative actions which are without merit. This constitutes a recognition by those States most intimately affected of the great possibility for misuse of the stockholder's derivative action. These States have created protection from "strike suits," and this protection is as much needed by a corporation when the source of the corporate cause of action which the shareholders seek to enforce derivatively is based upon federal law as when it is based upon State domestic law or foreign law. In both instances such corporations are required by the law of incorporation to pay the legal fees of the directors if they successfully defend.

Security-for-expenses provisions have been adopted by Congress in most of those sections where a private remedy has expressly been provided for. In addition, the leading commercial States, after serious investigation and consideration, all have concluded that this type of legislation is

necessary for the protection of the corporations created under their laws.

If the opinion of the lower court is left to stand, it would mean that by judge made law an exception to the all inclusive language of the State security-for-expenses statutes has been made by the lower court federal judges. The lower court federal judges also have rejected all of the federal statutory provisions providing for security for costs where Congress did spell out a private cause of action.

CONCLUSION.

For the reasons stated above, this Court is urged to issue its writ of certiorari to review the judgment of the Court of Appeals for the Third Circuit entered in the above matter.

Respectfully submitted,

WILLIAM T. COLEMAN, JR.,
Attorney for Petitioners.

DILWORTH, PAXSON, KALISH, KOHN & DILKS,
BRUCE W. KAUFFMAN,
Of Counsel.

October 24, 1961.

Appendix.

OPINION OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

GOODRICH, *J.* [Sitting Specially] June 2, 1960

This is an action by a shareholder against his corporation (the Borne Chemical Company), its officers and directors, and against a concern which purchased shares of the Borne Chemical Company (the CEM Securities Corporation). The complaint grows out of wrongs charged by the plaintiff to have been committed in connection with the purchase by CEM of shares of the Borne Corporation.

At this stage of the litigation the only question before the Court is that of providing security for costs.[1] The defendants ask that the plaintiff post such security; plaintiff denies that he must.

After reading the very detailed and extensive briefs filed by both parties the Court reaches the conclusion that some of the dispute is based on a misunderstanding by the defendants of what the plaintiff wants. The defendants say that plaintiff bases his claim for relief on (1) various state statutes, (2) Sections 5 and 11 of the Securities Act of 1933, 15 U. S. C. A. §§ 77e, 77k, and (3) Sections 10(b) and 29(b) of the Securities Exchange Act of 1934, 15 U. S. C. A.

1. The defendants have also filed motions (1) to dismiss the complaint for lack of jurisdiction over the subject matter, (2) to dismiss the complaint for failure to state a claim upon which relief can be granted, (3) to dismiss the complaint for failure to comply with Rules 8, 9(b) and 23(b) of the Federal Rules of Civil Procedure, and (4) to quash service of process against most of the defendants for lack of personal jurisdiction and/or improper venue.

All of these motions, which have been briefed by the defendant but not yet argued, have been held in abeyance pending the outcome of the motion for security for costs.

§§ 78j(b), 78cc(b), and SEC Rule X-10B-5. It is thought that the last brief filed by the plaintiff may help clear up this matter. In this brief the plaintiff commits himself to a definite theory of his action. He says: "The causes of action set forth in the Complaint are all based upon the violation of Rule X-10B-5 by defendants (with Section 29(b) providing a supporting basis for a cause of action by reason of the violations of Rule X-10B-5)." If this is what the plaintiff wants and all that the plaintiff wants, he is not required to post security. He has cited cases to this effect and the cases bear out his statements.[2] This position has the additional advantage of being supported by Professor Louis Loss, the foremost authority in the field.[3]

On the other hand, if the defendant is right that the plaintiff is shooting with a chokebore shotgun spraying shot in several directions, the defendant may be entitled to security for costs. If the plaintiff's claim is a "secondary right" of a shareholder asserted on behalf of his corporation, he may well have to provide for security in accordance with the Pennsylvania statute.[4] If it includes claimed

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2. See Fischman v. Raytheon Mfg. Co., 188 F. 2d 783, 788-89 (2d Cir. 1951); Acker v. Schulte, 74 F. Supp. 683, 690 (S. D. N. Y. 1947). Compare Montague v. Electronic Corp., 76 F. Supp. 933, 935-36 (S. D. N. Y. 1948) and Rosenberg v. Globe Aircraft Corp., 80 F. Supp. 123 (E. D. Pa. 1948).

3. Loss, SECURITIES REGULATION 1055, 1096 (1951), 1092 n. 487 (Supp. 1955).

4. "§ 1321. Plaintiff must be shareholder

"In any suit brought to enforce a secondary right on the part of one or more shareholders against any officer, or director, or former officer or director of a corporation, domestic or foreign, because such corporation refuses to enforce rights which may properly be asserted by it. . . ." PA. STAT. ANN. tit. 12 § 1321.

"§ 1322. Security for costs and attorneys' fees

"In any such suit instituted or maintained by holder or holders of less than five per centum of the outstanding shares of any class of such corporation's stock or voting trust certificates, the corporation in whose right such action is brought shall be entitled, at any stage of the proceedings, to require the plaintiff or plaintiffs to give security for

rights under the Securities Act of 1933, the same is true.[5]

The conclusion of the Court is this. If the plaintiff will file a statement within fifteen days limiting his claim in accordance with what has been said specifically in his brief (as indicated above), the motion for security of costs will be denied. If he is unwilling to do this, he must post security for costs and reasonable attorneys' fees in an amount to be determined upon submission of appropriate data. If he fails to do so his complaint will be dismissed.

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the reasonable expenses, including attorneys' fees, which may be incurred by it in connection with such suit, and by the other parties defendant in connection therewith, for which it may become liable pursuant to section three of this act, to which security the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may, from time to time, be increased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate." PA. STAT. ANN. tit. 12 § 1322.

"§ 1323. Assessment of costs

"The reasonable expenses, including attorneys' fees, of any party defendant incurred in connection with the successful defense of such suit shall be assessed upon the corporation, or if any party defendant shall be successful in part only, or if such action shall be settled with the approval of the court having jurisdiction thereof, the reasonable costs, including attorneys' fees, of any such party defendant shall be assessed upon the corporation in such amount as the court shall determine and find to be reasonable in the circumstances. The amount of all such expenses so assessed shall be awarded as costs of the suit and be recoverable in the same manner as statutory taxable costs." PA. STAT. ANN. tit. 12 § 1323.

5. See Section 11(e) of the Securities Act of 1933 15 U. S. C. A. § 77k(e).

ORDER OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

On this second day of June, 1960, the order of the Court is as follows:

1. If the plaintiff herein within fifteen days files a statement limiting his claim in accordance with the accompanying opinion, the motion for security is denied.

2. If such statement is not filed the plaintiff is to post security in an amount to be determined upon pain of dismissal.

/s/ GOODRICH,
Judge.

STIPULATION OF COUNSEL FOR PLAINTIFFS.

I am the counsel for the plaintiffs in the above entitled case. I stipulate that the causes of action which I am claiming and are set forth in my complaint are all based upon violations of Rule X-10B-5 by the defendants (with Section 29(b) of the Securities Exchange Act of 1934 providing a supporting basis for a cause of action by reason of the violations of Rule X-10B-5). I claim no other cause of action in this litigation against these defendants.

ARNOLD R. GINSGURG,
Arnold R. Ginsburg,
Attorney for Plaintiffs.

July 8, 1960

ORDER.

And Now, to wit, this 13 day of July, 1960, the plaintiffs having filed a stipulation on July 8, 1960 limiting the causes of action asserted by them in their complaint to causes of action based upon violations of Rule X-10B-5 by the defendants (with Section 29(b) of the Securities Exchange Act of 1934 providing a supporting basis for a cause of action by reasons of the violations of Rule X-10B-5), the defendants' motion for security for costs, including counsel fees, pursuant to Section 1321 of Title 12, Pa. Stat. Ann., § 11 of the Securities Act of 1933, as well as general equitable principles, is denied.

Goodrich,
Judge.

ORDER.

On this twentieth day of July, 1960, the order of July thirteenth, 1960, is amended as follows:

In the eighth line of the order the reference to Section 1321 of title 12, Pa. Stat. Ann., and so forth is changed to read "Section 1322".

Goodrich,
Judge.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 13,353

CHARLES A. McCLURE and RUTH E. McCLURE, suing on their own behalf and on behalf of all other stockholders of the Borne Chemical Company, Inc., similarly situated

v.

BORNE CHEMICAL COMPANY, INC., THOMAS E. BETNER, WILLIAM L. LESS, THOMAS A. MARINO, THE CEM SECURITIES CORPORATION, WALTER L. McMANUS, MARSHALL A. JACOBS, GEORGE E. ALLEN, CLYDE E. WILLIAMS, HENRY E. BRANDLI and H. CARL NORTHRUP

BORNE CHEMICAL COMPANY, INC.,
THOMAS E. BETNER,
WILLIAM L. LESS,
THOMAS A. MARINO,
MARSHALL A. JACOBS,
CLYDE E. WILLIAMS and
H. CARL NORTHRUP,

Appellants.

No. 13,354

CHARLES A. McCLURE and RUTH E. McCLURE, suing on their own behalf and on behalf of all other stockholders of Borne Chemical Company, Inc., similarly situated

v.

BORNE CHEMICAL COMPANY, INC., THOMAS E. BETNER, WILLIAM L. LESS, THOMAS A. MARINO, THE CEM SECURITIES CORPORATION, WALTER L. McMANUS, MARSHALL A. JACOBS, GEORGE E. ALLEN, CLYDE E. WILLIAMS, HENRY E. BRANDLI and H. CARL NORTHRUP

CEM SECURITIES CORPORATION and WALTER L. McMANUS,

Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued February 7, 1961

Before BIGGS, *Chief Judge*, and STALEY and HASTIE, *Circuit Judges.*

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

(Filed July 5, 1961)

By BIGGS, *Chief Judge.*

The question presented by these appeals is whether a shareholder who brings a derivative suit to enforce a corporate cause of action arising under Section 10(b), as

implemented by Securities and Exchange Commission Rule 10b-5, and Section 29(b) of the Securities and Exchange Act of 1934 may be required to post security for costs, including reasonable attorney's fees.

The plaintiffs hold as joint tenants 100 shares[1] of stock of the defendant, Borne Chemical Company, Inc., a New Jersey corporation having its principal office in New Jersey. The defendants are the Borne Chemical Company, Inc., its officers and directors, and CEM Securities Corporation, a Delaware corporation. The action is alleged to have been brought by the plaintiffs "on behalf of themselves in their individual capacities as stockholders," as a "spurious class suit" on behalf of themselves and others similarly situated, and also "to enforce their derivative or secondary rights as stockholders" of Borne. It is alleged that the defendants violated Rule 10b-5 in connection with the sale by Borne to CEM of 10,000 shares of the company's authorized but unissued capital stock. The complaint alleges that the plaintiffs were fraudulently deprived of their pre-emptive rights with respect to the 10,000 shares and that the shares were sold at an improperly low price, and that the defendants engaged in certain manipulative practices affecting the market price of the shares. It is further asserted that the acts complained of were done in furtherance of a conspiracy between the officers and directors of Borne, the majority stockholders of Borne, CEM, and CEM's controlling stockholder. The complaint sets forth various activities alleged to be breaches of fiduciary duties by the defendants which in turn constituted violations of Rule 10b-5. The plaintiffs stipulated in the court below "that the causes of action . . . are all based upon violations of Rule X-10B-5"[2] by

1. Nine hundred and three thousand shares have been issued.

2. Rule 10b-5, 17 Code of Federal Regulations 240.10b-5, was adopted by the Commission in 1942. It provides as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate com-

the defendants, with Section 29(b) of the Securities and Exchange Act of 1934 providing a supporting basis for a cause of action by reason of the violations of Rule 10b-5. The plaintiffs claim "no other cause of action in this litigation against these defendants". Injunctive relief, an accounting and rescission of the sale of stock by Borne to CEM, and other extensive relief are prayed for.

The defendants did not file an answer but moved to require plaintiffs to post security for expenses including reasonable attorneys' fees. In their motion the defendants asserted a right to security for expenses and counsel fees under the Pennsylvania Act of April 18, 1945, P.L. 253, No. 114, § 2, 12 Pa. Stat. § 1322, under Section 11(e) of the Securities Act of 1933, as amended, 15 U.S.C.A. § 77k(e), "as well as under equitable principles and rules." The court below denied the motion on condition that the plaintiffs file a statement limiting their claims to causes of action arising under Rule 10b-5 and Section 29(b). The plaintiffs did file such a statement which was accepted by the court below and the defendants have appealed.

The defendants make three arguments in support of their contention that a plaintiff who brings an action arising under Sections 10(b) and 29(b) of the Securities and Exchange Act of 1934, 15 U.S.C.A. §§ 78j, 77cc, may be required to post security for expenses including reasonable attorneys' fees. These three arguments seek to overcome the fact that no provision of Section 10(b), Rule 10b-5 or

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merce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Section 29(b) explicitly authorizes a court to require such security. First, it is contended that state law determines whether a plaintiff may be required to post security and that since both Pennsylvania, the State in which the court below sits and New Jersey, the State of incorporation and principal place of business of Borne Chemical Company, have security-for-expenses statutes, the defendants are entitled to the posting of security. Second, it is argued that under "general federal equity law" plaintiffs such as those at bar who bring derivative suits may be required to post security for expenses and that, therefore, even if state law be inapplicable the defendants are entitled to security. Third, the defendants assert that a security for expenses provision should be implied from Section 10(b) of the Securities and Exchange Act of 1934 by analogy to other provisions of the Securities Act which couple security for expenses provisions with provisions granting private rights of action. These arguments frame the three basic questions which must be considered. Preliminary to dealing with these questions, however, it is necessary to discuss the origin and nature of security for expenses statutes so that some of the fundamental considerations leading to our decision may be made plain.

Historically, the derivative suit has been the principal defense of the minority shareholder against abuses by the majority. In this era of the widening gulf between corporate control and corporate ownership, such suits have often served the further purpose of protecting the stockholders of a corporation against management which is sometimes unrepresentative and on occasion insufficiently concerned with the minorities' interests. Often where the wrongdoing is on the part of corporate officers and directors management has refused to act and where the wrongdoers control the corporation there is but small chance that the corporation itself will bring suit or vigorously prosecute the litigation. Equity, therefore, provided shareholders with the device of a derivative suit by means of

which they could assert the interest of their corporation against management and third parties when those in control of the corporation were acting in breach of their trust.

There were, of course, obvious dangers of abuse inherent in a device that allowed an individual member of an association, whose interest might be very small, to bring a suit on behalf of the entire association. Consequently, equity itself imposed many limitations on the use of the derivative suit designed to prevent its use as a means to usurp the power of management, of the majority, or to turn the suit to private advantage. For example, equity imposed the requirements of exhaustion of intra-corporate remedies,[3] of contemporaneous ownership,[4] and also defined an area of managerial discretion by developing the so-called "business judgment rule."[5] Despite these safeguards and others, however, there were many who felt that the abuses of the derivative suit as it had developed outweighed its utility as a tool by which corporate democracy and fiduciary duties could be enforced. Certain stockholders, it was observed, would sue the management in behalf of the corporation with no thought of gaining a corporate recovery but solely in the hope that manage-

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3. This doctrine originated in the chancery case of Foss v. Harbottle, 2 Hare 461 (Eng. Ch. 1843). The leading case in this country is Hawes v. City of Oakland, 104 U.S. 450 (1882). This decision is now embodied in Rule 23(b), Fed. R. Civ. Proc., 28 U.S.C. See generally the comprehensive treatment of the subject in Note, *Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit*, 73 Harv. L. Rev. 746 (1960).

4. See, *e.g.*, Home Fire Ins. Co. v. Barber, 67 Neb. 644, 93 N.W. 1024 (1903). Many courts have taken a contrary view, holding that a shareholder who purchases his stock after the wrong occurred may nevertheless maintain a derivative suit on behalf of the corporation. See, *e.g.*, Pollitz v. Gould, 202 N.Y. 11, 94 N.E. 1088 (1911), Parsons v. Joseph, 92 Ala. 403, 8 So. 788 (1891). In 1944 the New York legislature overruled the decision in the Pollitz case in enacting Section 61 of the N.Y. Gen. Corp. Code.

5. For statements of this rule see Hawes v. City of Oakland, *supra*, at p. 456-57; Corbus v. Alaska Treadwell Gold Mining Co., 187 U.S. 455, 463 (1903).

ment would "buy them off" by entering into a secret settlement with them. Some suitors gained financial advantages only by virtue of their nuisance value without having ever had a bona fide claim on behalf of the corporation. Moreover, it was vehemently suspected that many derivative suits were brought in the interest of attorneys seeking fees to be paid from the corporate treasury rather than by their clients who were often shareholders having so small an interest in the corporation as to render their ostensible concern for its welfare almost incredible.

In 1944 the Legislature of the State of New York enacted Section 61-b of the New York General Corporation Law, the first state security for expenses provision.[6] The law was based on a report made by Franklin S. Wood for a committee of the New York State Chamber of Commerce which contained an analysis of approximately 1300 derivative suits brought in the New York courts between 1932 and 1942 and which concluded that the equitable device was being abused. See Wood, Survey and Report Regarding Stockholders Derivative Suits (1944). Similar statutes were adopted in Maryland,[7] New Jersey[8] and Pennsylvania[9] in 1945. Subsequently, California[10] and Wiscon-

6. Section 61-b provides: "In any action instituted or maintained in the right of any foreign or domestic corporation by the holder or holders of less than 5 per centum of the outstanding shares of any class of such corporation's stock or voting trust certificates, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of $50,000, the corporation in whose right such action is brought shall be entitled at any stage of the proceedings before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney's fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject. . . . The amount of such security may thereafter from time to time be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive."

7. Rule 328. Maryland Rules of Procedure.

8. 14 N.J. Stat. Ann. § 3-15.

9. 12 Pa. Stat. § 1322.

10. Cal. Corp. Code § 834.

sin [11] adopted security for expenses statutes that vary substantially from the New York model. The majority of state legislatures have not enacted such legislation.

Generally a security for expense statute provides that shareholders with relatively small holdings may be required, by their corporation, to post bond for reasonable expenses including counsel fees which may be incurred, either directly or indirectly, by the corporation as a condition precedent to maintaining or recovering in a derivative suit. The theory is that the derivative suit is most abused by shareholder-plaintiffs who have relatively minor financial interests in the corporation. State legislatures have differed in their conceptions of what constitutes a minor financial interest for the purposes of these statutes. The New York and New Jersey statutes provide that security may be required of any derivative plaintiff who holds less than 5% of the aggregate par or stated capital value of all the outstanding shares of the corporation unless the market value of his shares is in excess of $50,000. Pennsylvania requires that the plaintiff have a 5% interest in the corporation regardless of the market value of his shares. Thus, the Pennsylvania statute brings many more shareholders of widely held corporations within its scope while often making it easier for shareholders of closely held corporations to bring suit. In California security may be required only upon a showing by the party moving for security that there is no reasonable probability that the suit will benefit the corporation or that the moving party did not participate in the transaction complained of. Moreover, under the California statute, not only the corporation but also other defendants in a derivative suit may require a plaintiff to post security.

From their inception security for expenses statutes have been the subject of heated controversy. Governor Thomas E. Dewey of New York in supporting the New York provision and its correlative contemporaneous ownership stat-

11. Wis. Stat. § 180.405(4).

ute, stated in a memorandum accompanying the two bills: "These two bills represent an effort to meet the problem created by the baseless so-called 'strike' stockholder suit against corporation directors and officers. In recent years a veritable racket of baseless lawsuits accompanied by many unethical practices has grown up in this field. Worse yet, many suits that were well based have been brought, not in the interest of the corporation or of its stockholders, but in order to obtain money for particular individuals who had no interest in the corporation or in its stockholders. Secret settlements—really pay-offs for silence—have been the subjects of common suspicion. . . . These bills represent a healthy experiment in cleansing our law courts of disreputable practices. . . ." The opposite view is well exemplified by the following passage from Hornstein, *New Aspects of Stockholders' Derivative Suits*, 47 Colum. L. Rev. 1, 3, 5 (1947): "The New York state legislation, since aped in other commercial states, was clearly designed to insulate corporate management from investors who discovered that the corporation had been looted. Had the legislators really been concerned with the so-called 'abuse' of stockholders' suits, the extortionate secret settlement, the remedy was painfully obvious: to bar secret settlements. This patent solution, twice recommended by the Law Revision Commission, was studiously avoided by the legislators. Instead, they adopted a series of laws of which not one was sponsored or recommended by the Law Revision Commission or the Judicial Council. The most drastic of these laws bars suits unless almost prohibitive conditions are met, . . . Meanwhile, the effective bar to suits, which the sponsors of the law hoped would result, has in fact resulted. In the two and a half years since enactment of the law, there appear to have been started in the Supreme Court, New York County, only four stockholders' suits involving widely-held corporations, three of which have been dismissed for non-compliance with the new laws. These four suits amounted to less than two a year,

as contrasted with an annual average of over fifty a year in the preceding decade." For similar views see House, *Stockholders' Suits and the Coudert-Mitchell Laws*, 20 N.Y.U.L.Q. 377 (1945); Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York*, 32 Calif. L. Rev. 123 (1944); Ballantine, *Corporations*, § 157(a) (rev. ed. 1946). We note that there is one proposition about which there is no controversy. A security for expenses statute poses a very serious obstacle to those shareholders to whom it applies who desire to maintain derivative suits.

I.

The Inapplicability of State Security for Expenses Statutes in Derivative Suits brought to enforce Rights arising under Sections 10(b) and 29(b) of the Securities and Exchange Act of 1934

The Pennsylvania security for costs statute is clearly inapplicable even though this action was commenced in a federal court sitting in that State. In Erie R.R. v. Tompkins, 304 U.S. 64 (1938), it was held that the substantive rules of law of the state in which a federal court sits are the rules of decision applicable in diversity actions brought in that court. That security for expenses statutes are "substantive" law as that term was used in the Erie decision was decided in Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541 (1949). In the present case, however, we are not concerned with a cause of action in which federal jurisdiction depends on diversity of citizenship, but with a case arising under a federal statute which itself confers jurisdiction upon the federal district courts. See Section 27(a) of the Act, 15 U.S.C.A. § 78aa. The Erie doctrine and the holding in the Cohen case are, therefore, not in point. See Rothenberg v. H. Rothstein & Sons, 183 F.2d 524, 528 (3 Cir. 1950).

The defendants argue, however, that the Pennsylvania statute should be applied in the present case on analogy to the doctrine whereby local statutes of limita-

tions are applied in cases arising under federal statutes which contain no provisions for limitations of action. We conclude, however, that the reasoning underlying that doctrine renders it inapposite in the case of a security for expenses statute. When Congress provides for limitations in a federal statute granting a right of action that provision is, of course, governing. But Congress on occasion does not make such provision and the question arises as to how to interpret congressional silence. In the landmark case of Campbell v. City of Haverhill, 155 U.S. 610 (1895), it was decided that in the absence of a limitations provision in an act of Congress, the statutes of limitations of the several states apply. The reason was that statutes of limitations embody a "cardinal principle of modern law" to which, it should be presumed, Congress intended to subject rights of action which it has created. In Holmberg v. Armbrecht, 327 U.S. 392 (1946), the Supreme Court reaffirmed the rationale articulated in the Campbell case. The Holmberg case presented the question whether local statutes of limitations as interpreted by state courts attach to federal statutory rights of action for which the sole remedy is in equity. Mr. Justice Frankfurter, writing for the Court, observed that, "As to actions at law, the silence of Congress has been interpreted to mean that it is federal policy to adopt the local law of limitation." But where Congress creates a right for which the sole remedy is in equity and "leaves to the federal courts the formulation of remedial details, it can hardly expect them to break with historic principles of equity in the enforcement of federally-created equitable rights." The Court went on to hold that federal equitable doctrines were applicable to mitigate the effect of the local statute of limitations. It is apparent that the doctrine of applying local statutes of limitation in cases at law and laches in suits in equity, Congress being silent, is based on the presumed congressional intent to have courts judicially imply a limitation provision. The presumption is justified by the

fundamental and universal nature of the concept of limitation and the improbability of Congress having intended to create a right not subject to a limitation period.

In the present case we are not dealing with congressional silence on limitations but silence on security for expenses. Unlike statutes of limitations, security statutes do not embody traditional principles of law which are universally accepted. There is sharp dispute as to their desirability and efficacy. Moreover, only a minority of our states have enacted such statutes. Under these circumstances a presumption that Congress intended that courts should imply a security requirement from a statute, granting an express or an implied private right of action seems unjustified. Congress cannot be presumed to have authorized the courts to engraft a unique and controversial limitation upon a statutory right through its silence on the subject of that limitation.

The question whether the New Jersey security for expenses statute applies poses a subtler problem.[12] Penn-

12. 14 N.J.S.A. § 3-15 provides: "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive."

sylvania's only significant contact with the present litigation is that it is the State in which the court below is located. Thus, since we have determined that both the Erie doctrine and the doctrine of presumed congressional adoption of local statutes of limitations are inapposite, we have disposed of the defendants' contention that Pennsylvania law is applicable. New Jersey, however, is the State of incorporation of Borne and also the site of its principal office. As such New Jersey has a clear interest in the relationships between the stockholders and the management of the corporation. Furthermore, as the Supreme Court pointed out in Cohen v. Beneficial Indus. Loan Corp., *supra,* at pp. 549, 550, "The very nature of the stockholders' derivative action makes it one in the regulation of which the legislature of a state has wide powers. Whatever theory one may hold as to the nature of the corporate entity, it remains a wholly artificial creation whose internal relations between management and stockholders are dependent upon state law and may be subject to most complete and penetrating regulation, either by public authority or by some form of stockholder action. . . . We conclude that the state has plenary power over this type of litigation."

As can be gathered from our general discussion of security for expenses statutes the New Jersey Legislature, when it enacted its statute, made a far-reaching and fundamental alteration of existing stockholders-management relationships. The right of a shareholder of a New Jersey corporation to bring a derivative suit was severely limited. Should this limitation be adhered to by a federal court when the corporate right that the plaintiff seeks to enforce derivatively arises under federal law? The answer to this question lies in both an examination of the state security for expenses requirement and the federal right under Rule 10b-5.

In *The Federal Courts and the Federal System*, at p. 435, Professors Hart and Wechsler, noting "[T]he interstitial character of federal law," observe that "Fed-

eral legislation, on the whole, has been conceived and drafted on an *ad hoc* basis to accomplish limited objectives. It builds upon legal relationships established by the states, altering or supplanting them only so far as necessary for the special purpose. Congress acts, in short, against the background of the total *corpus juris* of the states in much the way that a state legislature acts against the background of the common law, assumed to govern unless changed by legislation." Many instances of this phenomenon, unique to a federal system, can be found in the study of almost all of the myriad federal regulatory schemes. For example, in Price v. Gurney, 324 U.S. 100 (1945), the question was whether certain shareholders of a corporation could act for the corporation in filing a petition under Chapter X of the Bankruptcy Act. The court held that the question of the authority of persons filing such petitions to act on behalf of the corporation was controlled by local law even though the petition was to be filed pursuant to federal statute. See also Davies Warehouse Co. v. Bowles, 321 U.S. 144 (1944); Board of Commissioners v. United States, 308 U.S. 343 (1939). See generally Mishkin, *The Variousness of "Federal Law"*, 107 U. of Pa. L. Rev. 797 (1957). Thus, in the present case it could be argued that although the private rights of action granted by the Securities Acts, including those brought pursuant to Section 10(b) and 29(b), are federal rights of action, the question of which stockholders are entitled to enforce the corporate right of action arising under these federal statutory provisions is governed by the law of New Jersey, the state of incorporation and principal place of business. Arguably, it would follow that the shareholder-plaintiffs cannot proceed in the present case without posting security for expenses since, under New Jersey law, they could not proceed free of the security for expenses requirement.

In Fielding v. Allen, 181 F.2d 163, *cert. denied, sub nom.* Ogden Corp. v. Fielding, 340 U.S. 817 (1950), the

Court of Appeals for the Second Circuit had before it a question almost identical to that with which we are presently concerned. There a stockholder brought a derivative suit in part to enforce an alleged cause of action arising under the Interstate Commerce Act. It was asserted that a conspiracy existed between corporate officers, directors and others to fraudulently divest the corporation of assets in violation of the federal act. The district court granted the defendant's motion that the plaintiffs be required to post security for expenses pursuant to Section 61-b of the New York General Corporation Law. In holding the New York statute inapplicable to the federal count the Court of Appeals reasoned as follows: "Our next inquiry is whether this federally-based cause of action is subject to section 61-b. The right to be vindicated is that of Ogden Corporation. Since the corporation will not itself assert the right, equity allows a minority shareholder, under the circumstances alleged in the complaint, 'to step into the corporation's shoes and to seek in its right the restitution he could not demand in his own.' [Cohen v. Beneficial Loan Corp., 337 U.S. 541, 548; see also Hawes v. Oakland, 104 U.S. 450, 460]. Although it is clear that Ogden's right is federal in nature, the source of the shareholder's right to sue on it requires some further examination. If his right to maintain this derivative action is one which he possesses only by virtue of state law, his suit may be subject to the condition which New York has imposed even though the corporate right is federal. This we need not decide, however, for we think that the stockholder's right to maintain a derivative action on a corporate right federal in nature is federally conferred. As long ago as Payne v. Hook, 7 Wall. 425, 430, 19 L. Ed. 260, it was held: 'The equity jurisdiction conferred on the Federal courts is the same that the High Court of Chancery in England possesses; is subject to neither limitation or restraint by State legislation, and is uniform throughout the different States of

the Union.' (See also Sprague v. Ticonic Nat. Bank, 307 U.S. 161, 164; Guaranty Trust Co. v. York, 326 U.S. 99, 105, 106).

"It may be conceded that this doctrine no longer applies in diversity cases. There the policy of uniformity within the federal system must give way to the policy of uniformity between the federal court and the courts of the state in which it sits. [Ruhlin v. N. Y. Life Ins. Co., 304 U.S. 202; Guaranty Trust Co. v. York, 326 U.S. 99.] But we think that the policy enunciated in Payne v. Hook, supra, retains its vigor in non-diversity cases. In such cases, if a form of relief exists within the ambit of the federal court's historic equity jurisdiction, it should be available without reference to the peculiar requirements of local law. As Professor Moore puts it: 'Whether equitable relief should be granted and to what extent in federal matters is a matter properly within the domain of federal equity jurisprudence. Here, unlike in diversity cases, the federal courts are free of state remedial law.' 2 Moore's Federal Practice (2d ed.), Par. 2.09, p. 456.

"The stockholder's derivative suit is such a form of relief. The action was early recognized by Chancery. [Foss v. Harbottle, 2 Hare 461.] It has long been familiar in the federal courts. [Dodge v. Woolsey, 18 How. 331, 15 L. Ed. 401; Hawes v. Oakland, 104 U. S. 450.] And since the passage of the Act of March 3, 1875, 18 Stat. 470 [see 28 U.S.C.A. § 1331], conferring federal jurisdiction over cases arising under the Constitution and laws of the United States, many federal questions of importance have been raised in stockholder's derivative actions. [See, e.g., Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 553; Ex parte Young, 209 U.S. 123, 143; Brushaber v. Union Pacific R. Co., 240 U.S. 1, 9; Ashwander v. T. V. A., 297 U.S. 288, 318. And see 13 Fletcher Cyclopedia Corporations Sec. 5987]. Consequently we think that the right of a stockholder to sue on his corporation's federal cause of action is itself federal in nature and therefore not subject

to special requirements for cognate actions under state law. [See Stella v. Kaiser, D.C.S.D.N.Y., 81 F. Supp. 807.] Accordingly the plaintiffs ought not to have been required to furnish security under section 61-b as a condition precedent to the prosecution of their second cause of action. . . . It must be conceded, however, that the question is not free from doubt."

We agree with the result reached by the Second Circuit in the Fielding case and with its reasoning that in a case such as that at bar the policy of uniformity within the federal system is stronger than any policy of conformity with local rules. As we have pointed out only a minority of states have adopted security statutes and the statutes differ from one another. There is much to be said for the argument that a federal right, uniform in its nature throughout the nation, should be uniformly enforceable pursuant to federal standards. That Congress intended uniform enforcement of rights arising under The Securities and Exchange Act of 1934 is indicated strongly by the fact that it gave exclusive jurisdiction to the United States courts of any suit brought to enforce the duties or liabilities created by the Act. See Section 27 of the Act, 15 U.S.C.A. § 78aa.

There is a further difficulty with the argument that the right of action under Section 10(b) should be deemed to be superimposed upon state law limiting the class of shareholders eligible to bring derivative suits. One of the most important factors in those cases applying state law to federally-based causes of action has been a presumption that Congress has acted with established state doctrine in mind and has thus intended that state law be "absorbed" into the federal statute. See, *e.g.*, Davies Warehouse Co. v. Bowles, 321 U.S. 144 (1944). In the instant case, however, the Securities Exchange Act of 1934 was enacted over a decade before the first state security for expenses statute. It cannot be argued successfully therefore, that Congress had these statutes in mind as a

background against which it enacted the Exchange Act. Moreover this is not a case in which state law must be applied in adjudicating a federal right because there is no body of federal law with respect to the question presented. In De Sylva v. Ballentine, 351 U.S. 570 (1956) the determinative issue was whether illegitimate children were "children" within the meaning of the Copyright Act, 17 U.S.C. § 24. The Supreme Court looked to state domestic relations law for the answer, reasoning, in part, as follows: "The scope of a federal right is, of course, a federal question, but that does not mean that its content is not to be determined, by state, rather than federal law . . . . This is especially true where a statute deals with a familial relationship: there is no federal law of domestic relations, which is primarily a matter of state concern . . . ." 351 U.S. at 580. See *Mishkin, The Variousness of "Federal Law"*, 105 U. Pa. L. Rev. 797, 820-24 (1957). In the present case there is a comprehensive body of federal law with respect to the bringing of derivative suits. Indeed, the derivative suit, and the limitations upon its use, were initially developed in the federal courts. See Dodge v. Woolsey, 59 U.S. 331 (1855); Hawes v. City of Oakland, 104 U.S. 450 (1882). There is, therefore, no compulsion in the present case to adopt state law because it is the only developed body of law pursuant to which this federal right may be enforced.

What is more important, we do not believe that Sections 10(b) and 29(b) of the Securities and Exchange Act should be construed as being superimposed upon the stockholder-management relationship defined by state security for expenses statutes, since the federal provisions are a part of a statutory scheme which had as its purpose the creation of a new federal law of management-stockholder relations and which, therefore, may not be subordinated to limitations such as security for expenses statutes, reflecting state policy in the same area. It is true that federal law often depends upon state-created legal relation-

ships. Admittedly, where, precedent to the enforcement of a federal right, a question arises on the resolution of which Congress has been silent, state law will be controlling in many instances. But state law will only control where that law will not cut across the federal interests receiving expression in the federal right sought to be enforced. This principle was best enunciated by Mr. Justice Frankfurter in Board of County Commissioners, *supra*, at pp. 350-52, as follows: "With reference to other federal rights, the state law has been absorbed, as it were, as the governing federal rule not because state law was the source of the right but because recognition of state interests was not deemed inconsistent with federal policy. . . . In the absence of explicit legislative policy cutting across state interests, we draw upon a general principle that the beneficiaries of federal rights are not to have a privileged position. . . ." See also D'Oench Duhme & Co. v. FDIC, 315 U.S. 447, 467-75 (1942). In the present case we are construing two sections of the Securities and Exchange Act of 1934. That Act deals with the protection of investors, primarily stockholders. It creates many managerial duties and liabilities unknown to the common law. It expresses federal interest in management-stockholder relationships which theretofore had been almost exclusively the concern of the states. Section 10(b) imposes broad fiduciary duties on management vis-a-vis the corporation and its individual stockholders. As implemented by Rule 10b-5 and Section 29(b), Section 10(b) provides stockholders with a potent weapon for enforcement of many fiduciary duties. It can be said fairly that the Exchange Act, of which Sections 10(b) and 29(b) are parts, constitutes far reaching federal substantive corporation law. See the illuminating summary of the background of the Securities Acts in Loss, Securities Regulation 3-16, 56-82 (1951).

As we have pointed out, state security for expenses statutes are more than procedural modifications. They are, rather, fundamental regulations of the management-

shareholder relationship. As such they cut across a similar federal interest embodied in the Securities Acts. If held to be applicable in actions under Section 10(b) they would limit severely the scope of that section in an area comprehended by the statutory scheme. Where a unique and controversial state doctrine alters relationships that are the principal concern of a federal statute that doctrine will not be applied to limit rights arising under the federal statute. Thus state interest in the present suit must be subordinated to the federal policy occupying the same field. We conclude, therefore, that the question whether security for expenses may be required in the present case must be resolved by reference to federal law. See Rothenberg v. H. Rothstein & Sons, 183 F.2d 524 (3 Cir. 1950).

II.

Under "General Federal Equity Law" a Derivative Plaintiff enforcing a Corporate Right of Action pursuant to Rule 10b-5 may not be required to post Security for Expenses.

The defendants have argued that even if state law is inapplicable in the present case the plaintiffs may be required to post security for expenses under "general federal equity law". The defendants have not, however, cited any authority for this proposition and our research has disclosed none. We are of the opinion that the contention of the defendants is erroneous.

Traditionally the courts of both our state and federal systems have taxed costs only "as between party and party". Nevertheless, in certain exceptional classes of cases courts of equity have taxed costs "as between attorney and client". That is they have awarded litigation expenses, including reasonable attorney's fees, to the prevailing party. The law on this subject is set out in great detail in Guardian Trust Co. v. Kansas City Southern Ry., 28 F.2d 233 (C.C.A. 8 1928). See also Sprague v. Ticonic Nat'l Bk., 307 U.S. 161 (1939). All of the cases

in which litigation expenses have been awarded to the prevailing party had proceeded to final judgment. In none of those cases was security for expenses required of either of the parties.

There are certain exceptional cases in which a United States district court has inherent power to require security for costs. See 6 Moore, Federal Practice 1325-32 (2 ed. 1953). Security for costs may also be required in those narrow situations in which local rules of the district court so provide. In the Eastern District of Pennsylvania, for example, where this suit was brought, Local Rule 35 authorizes a district judge to require a plaintiff who is not a resident of the district to post security for costs. But, the distinction between security for costs and security for expenses, must be kept in mind. The former usually involves a relatively small initial outlay on the part of the plaintiff, whereas the latter, including as it does all reasonable litigation expenses, often requires a very large outlay by the plaintiff precedent to his obtaining judgment. We have found no case in which a court has required security for expenses, as opposed to security for costs, without express statutory authority. Nor have we found a case which has posited circumstances under which such an undertaking might be required. We therefore, reject the defendants' argument on this point.

In so doing we are not unmindful of our obligation to preserve and foster the tradition of growth in federal equitable doctrine. As we have pointed out previously, however, to require security for expenses of derivative plaintiffs would be to adopt a rule about which there is much controversy. In addition, it would entail the imposition of a severe limitation on a means of enforcing federal law relating to stockholder-management relationships. Too many legislative, as opposed to judicial, considerations are involved in making such a decision. In such circumstances a court should adhere to traditional practice. As we have pointed out that practice has not permitted a federal equity court to require the posting of security for expenses.

III.

A Security for Expenses Provision may not be implied from Section 10(b) and Rule 10b-5 by Analogy to Other Provisions of the Securities Act which couple Security for Expenses Provisions with Provisions granting Private Rights of Action.

In the landmark case of Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946), Chief Judge Kirkpatrick held that a violation of Section 10(b) and Rule 10b-5 which implements it renders the violator liable to the members of the class for whose benefit the statute was enacted and the Rule promulgated. Neither Section 10(b) nor Rule 10b-5 explicitly grants a private right of action. The basis of the Kardon doctrine was the common law tort rule, as articulated in Section 286 of the Restatement of Torts, that a private right of action may be implied from a statute in favor of those whose interests the statute was designed to protect.

It is arguable that where a private remedy is implied from a statute in which security for expenses provisions have been coupled with the provisions in which private rights of action have been granted explicitly, a security for expenses limitation should be implied along with the implied private remedy. This argument is, of course, tenable only where the statute evinces a clear policy in favor of security for expenses limitations. Even then, we believe, there would be a serious question whether a court, in the proper exercise of its judicial function, could carry the traditional tort doctrine of implication of private remedies to such a length. With respect to Section 10(b) and Rule 10b-5, however, we do not have to deal with the extent to which we can impose limitations on private rights of action implied from statutes because we have concluded that the Securities Acts do not evince a sufficiently clear or uniform policy in favor of security for expenses provisions to justify the imposition of such a limitation on

the private right of action which has been implied from Section 10(b).

Section 11 of the Securities Act of 1933 confers on buyers of securities rights of action against persons connected with the making of untrue statements in registration statements. Subsection (e) of Section 11, as amended, 15 U.S.C.A. § 77k(e), provides in part that "In any suit under this or any other section of this title the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes that the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard." This provision also applies to suits under Section 12 of the Act, 15 U.S.C.A. § 77b, which grants remedies to buyers against fraudulent sellers or those who sell in violation of Section 5 of the Act, 15 U.S.C.A. § 77e. It should be noted that this provision is not limited to derivative suits and applies equally to plaintiffs and defendants. A further difference between this provision and the usual state statute is that it is not mandatory but discretionary with the trial court as to whether to require security. Furthermore, expenses are not assessed against a party merely because he loses the suit, but only in the case of a non-meritorious suit or defense.

Section 9(e) of the Exchange Act, 15 U.S.C.A. § 781, which confers rights of action on persons injured by willful unlawful manipulations of security prices, has a somewhat different security for expenses provision which is as follows: "In any such suit the court may, in its discretion,

require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant." Section 18(a) of the Act, 15 U.S.C.A. § 78r, dealing with liability for misleading statements contains an identical provision.[13] But Section 16(b) of the Exchange Act, 15 U.S.C.A. § 78p, which grants rights of action to shareholders injured by "insider-trading" has no security for expenses requirement. Similarly, Section 29(b) of the Act, pursuant to which this action is brought in part, does not contain a security requirement.

It is apparent that the Acts do not manifest sufficiently clear or uniform policy favoring security for expenses to allow us to imply such a limitation from Section 10(b). Were we to attempt to do so we would have to discover some reason for following the course Congress took with respect to the Securities Act and Sections 9(e) and 18(a) of the Exchange Act rather than that exemplified by Section 16(b). But there seems no rational basis for concluding that the right of action implied from Section 10(b) bears a greater similarity to the sections limited by security requirements than it does to Section 16(b) which is unencumbered by that requirement. Indeed, a persuasive argument could be made that the plaintiffs' complaint in the present case, alleging as it does fraudulent dealings by insiders to the detriment of stockholders, sounds as much in Section 16(b) as in any other liability section contained in the Acts. Moreover, even if we decided against the analogy to 16(b) we would be faced with the impossibility of making a rational choice between the provision contained in Section 11(e) on the one hand

13. Courts have been reluctant to require plaintiffs to post security for expenses even pursuant to the explicit provisions of the Securities Acts. See Loss, *Securities Regulation* 1093-94 (1951). Professor Loss suggests that the courts which have considered the problem were influenced by the readiness with which plaintiff's motives are attacked in stockholder suits. See Craftsman Fin. & Mtge. Co. v. Brown, 64 F. Supp. 168 (S.D.N.Y. 1945).

and Sections 9(e) and 18(a) on the other. For these reasons we decline to imply a security for expenses requirement from Section 10(b) or Rule 10b-5.[14]

We conclude therefore that a shareholder who brings a derivative suit to enforce a cause of action arising under Section 10(b), as implemented by Rule 10b-5, and Section 29(b) of Securities and Exchange Act of 1934, may not be required to post security for expenses. Our holding is in accord with that of the Court of Appeals for the Second Circuit in Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 788-89 (1951). It also agrees with the statement of the law appearing in Professor Loss's *Securities Regulation* (1951) at pp. 1055, 1094, n. 493, 1096.

The order appealed from will be affirmed.

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14. Borne does not contend that security for expenses may be required of the plaintiffs with respect to that part of the cause of action which is based on Section 29(b). It is apparent that our reasoning as to Section 10(b) and Rule 10b-5 is equally applicable to the question whether security for expenses may be required of a plaintiff asserting a cause of action arising under Section 29(b). Moreover, it has been held that Section 29(b) grants an express right of action as opposed to the implied right of action under Section 10(b). See Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D.Pa. 1946). If this view of Section 29(b) be accepted, the fact that Congress did not attach a security requirement to that Section would be conclusive.

JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of July 13, 1960, as amended by order of July 19, 1960, be, and the same is hereby affirmed, with costs.

Attest:

IDA O. CRESKOFF,
Clerk.

July 5, 1961.

ORDER OF UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DENYING PETITION FOR REHEARING.

Present: BIGGS, *Chief Judge,* and STALEY and HASTIE, *Circuit Judges.*

After due consideration the petition for rehearing in the above-entitled case is hereby denied.

By THE COURT:

BIGGS,
Chief Judge.

Dated: September 19, 1961.

No. 516

In the Supreme Court of the United States

OCTOBER TERM, 1961

BORNE CHEMICAL COMPANY, INC., THOMAS E. BETNER, WILLIAM L. LESS, THOMAS A. MARINO, THE CEM SECURITIES CORPORATION, WALTER L. McMANUS, MARSHALL A. JACOBS, GEORGE E. ALLEN, CLYDE E. WILLIAMS, HENRY E. BRANDLI and H. CARL NORTHRUP,

Petitioners

v.

CHARLES A. McCLURE and RUTH H. McCLURE, suing on their own behalf and on behalf of all other stockholders of Borne Chemical Company, Inc., similarly situated,

Respondents

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 516

BORNE CHEMICAL COMPANY, INC., THOMAS E. BETNER, WILLIAM L. LESS, THOMAS A. MARINO, THE CEM SECURITIES CORPORATION, WALTER L. MCMANUS, MARSHALL A. JACOBS, GEORGE E. ALLEN, CLYDE E. WILLIAMS, HENRY E. BRANDLI and H. CARL NORTHRUP,

Petitioners

v.

CHARLES A. MCCLURE and RUTH H. MCCLURE, suing on their own behalf and on behalf of all other stockholders of Borne Chemical Company, Inc., similarly situated,

Respondents

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

Opinions Below

The opinion of the Court of Appeals for the Third Circuit (Pet. 6a-30a) is reported at 292 F. 2d 824. The opinion of the District Court for the Eastern District of Pennsylvania (Pet. 1a-3a) is not reported.

Jurisdiction

The judgment of the Court of Appeals (Pet. 31a) was entered on July 5, 1961. The order of the Court of Appeals denying a petition for rehearing (Pet. 32a) was entered

on September 19, 1961. The petition for a writ of certiorari was filed on October 25, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

Question Presented

Whether the Court of Appeals properly held, in affirming an order of the District Court, that plaintiff shareholders, the respondents herein, cannot be required to post security for costs, including counsel fees, in a non-diversity federal action (diversity of citizenship not being available or alleged as a basis for jurisdiction) invoking federal jurisdiction exclusively under the Securities Exchange Act of 1934 (a federal statute giving the federal district courts exclusive jurisdiction of all such actions) against the officers and directors of their corporation and other defendants (all of whom are petitioners herein), plaintiffs suing derivatively on behalf of their corporation, suing in their own right, and bringing a spurious class suit, where the complaint alleges and the plaintiffs claim that the causes of action set forth in the complaint are all based exclusively upon defendants' alleged violations of Section 10(b) of the Securities Exchange Act of 1934, and of Rule 10b-5 (formerly called and sometimes still referred to as Rule X-10B-5) adopted thereunder by the Securities and Exchange Commission, with Section 29(b) of said Act providing a supporting basis for a cause of action by reason of the violations of Rule 10b-5, there being no security requirement provision in Section 10(b), Section 29(b), or Rule 10b-5, although the State of incorporation and the forum State both have statutes providing for such security in stockholder derivative actions.

Statutes and Rule Involved

Section 10(b) of the Securities Exchange Act of 1934, as amended (the "Act"), 15 U.S.C. §§78a, 78j, is set forth at page 6 of the petition.

Rule 10b-5 (17 Code of Federal Regulations 240.10b-5) was adopted in 1942 by the Securities and Exchange Commission, under its original designation of Rule X-10B-5, pursuant to the authority of Sections 10(b) and 23(a) of the Act, 15 U.S.C. §§78j, 78w. Rule 10b-5, which is set forth in the opinion of the Court of Appeals (Pet. 8a-9a), provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
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> (1) to employ any device, scheme, or artifice to defraud,
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> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
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> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security."

Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. §78aa) provides:

> "The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have *exclusive jurisdiction* of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the

rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. . . ." (Emphasis added.)

Section 29(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78cc(b)) provides:

"Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or regulation: *Provided*, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of section 15 of this title, and (B) that no contract shall be deemed to be void by reason of this sub-

> section in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 15 of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation."

The New Jersey statute (14 N.J. Stat. Ann. §3-15), upon which petitioners rely, is set forth in full in the opinion of the Court of Appeals at Pet. 17a. The Pennsylvania statute (12 Purd. Pa. Stat. §1322), upon which petitioners rely, is set forth in full in the opinion of the District Court at Pet. 2a-3a.

Statement of the Case

Petitioners seek a review by this Court of the judgment (Pet. 31a) of the Court of Appeals for the Third Circuit (Biggs, Chief Judge, and Staley and Hastie, Circuit Judges) affirming the order (Pet. 5a) of Circuit Judge Goodrich, sitting specially in the District Court for the Eastern District of Pennsylvania, denying the motions of petitioners to require respondents to post security for costs, including counsel fees. Petitioners filed a petition for rehearing with the Court of Appeals which was denied (Pet. 32a).

The opinion of the Court of Appeals, written by Chief Judge Biggs, is set forth at pages 6a-30a of the petition. Judge Goodrich's opinion in the District Court is set forth at pages 1a-3a of the petition.

Respondents brought this action in the United States District Court for the Eastern District of Pennsylvania exclusively under and pursuant to Sections 10(b), 27 and 29(b) of the Securities Exchange Act of 1934 (15 U.S.C. §§78a, 78j, 78aa, 78cc), a federal statute, and Rule 10b-5

(Rule X-10B-5)[1] adopted by the Securities and Exchange Commission ("SEC"), a federal agency, under the authority of Sections 10(b) and 23(a) of the Act (App. 7a).[2] The causes of action set forth in the complaint (App. 7a-40a) are all based upon the violation of Rule 10b-5 by petitioners (with Section 29(b) providing a supporting basis for a cause of action by reason of the violations of Rule 10b-5).

The federal jurisdiction of the District Court was invoked in this action solely under and by reason of Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. §78aa), which grants the federal district courts "exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder" (App. 7a). *No diversity of citizenship was alleged and complete diversity between respondents and petitioners (plaintiffs and defendants) does not exist.*

Respondents filed the complaint (App. 7a-38a) in District Court on December 19, 1959, and a supplement to complaint (App. 1b-6b) on January 18, 1960. Plaintiffs are small stockholders of petitioner Borne Chemical Company, Inc. ("Borne"), a New Jersey corporation having its principal office in New Jersey, jointly owning 100 shares of its capital stock at the time of the transactions

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[1] When adopted by the SEC in 1942 this rule was designated as Rule X-10B-5. Though now renamed Rule 10b-5, it is still widely referred to as Rule X-10B-5. Until recently most courts and writers have used the designation Rule X-10B-5. The complaint herein, while noting its new name (App. 8a), referred to this rule as Rule X-10B-5. So did the opinion and order of the District Court (Pet. 1a-5a). The opinion of the Court of Appeals (Pet. 6a-30a) referred to it as Rule 10b-5. This is the designation used generally in this brief. The petition for writ of certiorari uses the designation Rule X-10B-5. The full text of this rule is set forth *supra* at page 3.

[2] "App." refers to the printed appendices filed by the appellants and appellees in the Court of Appeals, which appendices are part of the record filed in this Court.

complained of and at all times since (App. 8a-9a). The defendants and petitioners herein are Borne, its officers and directors, and The CEM Securities Corporation ("CEM"), a Delaware corporation (App. 10a-11a). The complaint alleged that plaintiffs bring this action "on behalf of themselves in their individual capacities as stockholders" of Borne; as a "spurious class suit" on behalf of themselves and all other stockholders of Borne similarly situated, numbering more than 1,000; and "on behalf of themselves and all other stockholders similarly situated to enforce their derivative or secondary rights as stockholders" of Borne (App. 9a-10a).

It is alleged that the defendants violated Rule 10b-5 in connection with the sale by Borne to CEM of 10,000 shares of Borne's authorized but unissued capital stock pursuant to an agreement made November 25, 1959. The complaint alleges that the defendant officers and directors of Borne (including its two majority and controlling stockholders), together with defendant CEM and its controlling stockholder as participants and co-conspirators (App. 27a), used a "manipulative or deceptive device or contrivance" within the meaning of Section 10(b) of the Act (App. 21a), employed a device, scheme or artifice to defraud, and engaged in acts, practices or a course of business which operated and operates or would operate as a fraud or deceit upon Borne Chemical Company, Inc., the plaintiffs and other stockholders of Borne, and made untrue statements of material facts or omitted to state material facts necessary to make statements made (in the light of the circumstances under which they were made) not misleading, all in violation of the specific provisions of Rule 10b-5, in connection with said sale of 10,000 shares.

The complaint alleges that the defendants caused Borne to sell the 10,000 shares to CEM at an improperly low price; that the price was low at the time it was fixed and "extremely low in the light of subsequent market prices" (App. 20a, 24a-25a); that the market prices of

and the volume of trading in Borne's stock (which is traded but not listed on the American Stock Excharge) sharply increased immediately after the agreement to sell to CEM was entered into on November 25, 1959, continuing to and beyond the filing of the complaint on December 19, 1959 (App. 16a, 20a-22a; 4b); that by virtue of this substantial increase in market price from the date of the CEM agreement to the date, almost a month later, when the shares were finally issued to CEM and the deal was consummated, CEM received stock having a market value then of $350,000 or more in return for a purchase price of only $220,000, thus depriving Borne (and its stockholders, including respondents) of potential corporate funds amounting to $130,000 or more (App. 22a); and that the increased volume of trading of Borne stock on the American Stock Exchange, and the substantial increase in price thereof, "are attributable, at least in substantial part, to trading and other activities by defendants and other corporate insiders, directly or indirectly, which activities constitute 'manipulative or deceptive devices or contrivances' and unlawful conduct" within the meaning of Section 10(b) of the Act and Rule 10b-5 (App. 21a).

It is further alleged that Borne Chemical Company, Inc. "and the present officers and directors of the Company are under the domination and control of defendants Betner, Less and McManus who are substantial stockholders and directors of Company and who are the principal persons responsible for the transaction, acts and course of conduct complained of herein" (App. 9a); and that, at all times relevant hereto, Betner and Less, between them, owned or controlled a majority of all of Borne's outstanding shares of stock (App. 11a). Betner is President of Borne, Less is Chairman of the Board, and McManus is an officer, director and a controlling stockholder of CEM (App. 9a, 11a-12a). McManus was made a director of Borne between the date of the CEM agreement and the

date the sale of stock was consummated (App. 11a). It is alleged that, as a result of the sharp increase in market price of Borne stock beginning immediately after the CEM agreement was entered into on November 25, 1959, within a period of three weeks thereafter, by the time respondents had instituted this suit and before the sale of stock to CEM was consummated, the blocks of shares of Borne stock owned or controlled by petitioners Betner and Less had each appreciated in market value by more than $3,000,000 (or $6,000,000 in aggregate), and the block of shares of Borne stock owned by petitioners CEM and or McManus on November 25, 1959 (excluding the 10,000 shares in question) had appreciated in market value by approximately $400,000 (App. 21a-22a).

It is alleged that the acts, transactions and other violations of Rule 10b-5 complained of were schemed and done in furtherance of a conspiracy among the officers and directors of Borne, the majority stockholders of Borne, CEM, and CEM's controlling stockholders, all of whom are petitioners herein, which was intended to defraud and, in fact, operated as a fraud upon Borne, upon the respondents and upon other stockholders similarly situated, all within the meaning of Rule 10b-5 and in violation thereof (App. 9a, 27a-28a, 30a).

Contrary to the erroneous statements in the petition that respondents "claimed that petitioners violated their state-imposed fiduciary duties" (Pet. 7) and "state-created" fiduciary obligations (Pet. 2), the complaint alleged that the defendant officers, directors and controlling stockholders violated Rule 10b-5 in breaching a number of important fiduciary obligations to Borne Chemical Company, Inc. and/or its stockholders (Pet. 23a-27a, 28a-34a), such fiduciary obligations arising under Rule 10b-5 the broad anti-fraud objectives of which require corporate insiders to observe high fiduciary standards toward their corporation and its stockholders and require the "applica-

tion of well known and well established equitable principles governing fiduciary relationships." [3]

Thus, among other violations of Rule 10b-5 through the breach of fiduciary obligations arising thereunder, the complaint alleged a violation of Rule 10b-5 in that defendants breached their fiduciary obligation to make full and timely disclosure to plaintiffs and other stockholders of all material facts pertaining to the proposed sale of 10,000 shares to CEM, the proposed amendment of the by-laws terminating preemptive rights, and other matters complained of in this action (App. 26a). In this connection, the complaint alleged in detail the respects in which petitioners breached their fiduciary obligations (all in violation of the anti-fraud provisions of Rule 10b-5) to make full and honest disclosure of all material and relevant facts in the proxy material and proxy statement mailed to respondents and other stockholders in soliciting their proxies for a special meeting of stockholders to vote for the elimination of preemptive rights, and to refrain from making such proxy material and proxy statement untruthful or misleading whether through statements or omissions made therein (App. 33a-34a). The affirmative vote of two-thirds of the stockholders to amend the by-laws to terminate preemptive rights, and the defendant management's solicitation of proxies in connection therewith, each constituted an integral part of the entire transaction complained of, and each must be construed as being "in connection with the purchase or sale" of securities within the meaning of Rule 10b-5 (App. 35a). Consummation of the transaction depended upon such affirmative vote of stockholders and upon the success of defendants' proxy solicitation. It is alleged that the petitioners fraudulently deprived the respondents and all other stockholders of their preemptive rights with respect to the 10,000 shares sold to CEM, a

[3] *Kardon v. National Gypsum Co.*, 73 F. Supp. 798, 803 (E.D. Pa. 1947).

substantial stockholder of Borne, in a preferred sale (App. 28a-30a).

Plaintiffs seek only equitable relief in this action (App. 36a-38a; 5b). The complaint originally sought to enjoin the holding of the special meeting of stockholders called to vote on the termination of preemptive rights and to enjoin the consummation of the sale to CEM, but this is now moot. The relief still sought involves the rescission of the agreement of November 25, 1959 with CEM and the transaction in which Borne issued 10,000 shares of stock to CEM, to return said shares to Borne. The prayer requests that this agreement be adjudged void by virtue of Section 29(b) of the Securities Exchange Act of 1934; that the defendants be found to have violated Rule 10b-5 and Section 10(b) of the Act; that defendants be enjoined from continuing to violate the same; and that the defendants be directed to make a full and complete disclosure. Plaintiffs also request that defendants be directed to render an accounting and to make appropriate and full reimbursement and payment to Borne, the plaintiffs and other stockholders for all loss, injury and damage suffered by the latter and for all moneys, property, proceeds and emoluments received by defendants by reason of the violations of Rule 10b-5 complained of herein.

The defendants did not file answers to the complaint but moved to require plaintiffs to post security for expenses including reasonable attorneys' fees. The defendants based their motion for security on a Pennsylvania statute (12 Purd. Pa. Stat. §1322), on Section 11(e) of the Securities Act of 1933, as amended (15 U.S.C. §77(k)(e)), and on "equitable principles and rules" (App. 39a-40a).

Circuit Judge Goodrich, sitting specially in District Court, denied defendants' motions for security on condition that the plaintiffs file a statement, in accordance with what plaintiffs had previously stated, limiting their claims to causes of action arising under Rule 10b-5 and Section 29(b) (Pet. 1a-5a). Plaintiffs complied therewith and con-

firmed the clear intent of the complaint by filing a stipulation (Pet. 4a) in the District Court stating that the causes of action claimed and set forth in the complaint "are all based upon violations of Rule X-10B-5 by the defendants (with Section 29(b) of the Securities Exchange Act of 1934 providing a supporting basis for a cause of action by reason of the violations of Rule X-10B-5)", and further stating that plaintiffs "claim no other cause of action in this litigation against these defendants".

Petitioners err in stating (Pet. 8) that "The District Court denied petitioners' motion on the ground that where the pleadings claim that the corporate cause of action was based upon violation of a federal *criminal* statute, the State statute with respect to security for costs in a derivative action cannot be applied" (Emphasis added). The District Court made no such reference to a "criminal" statute.

On appeal taken by petitioners, the United States Court of Appeals affirmed the order of the District Court denying petitioners' motions for security (Pet. 6a-31a).

Argument

The petition presents a narrow issue arising in this private litigation under the Securities Exchange Act of 1934. No matter how much the petition strains to show that the decision below conflicts with decisions of this Court and with a recent decision of the Seventh Circuit, no matter how much the petition labors to give "public importance" to the issue presented, no matter how many times the petition says the decision below is wrong, a reading of the petition and of the magnificent, well-reasoned opinion of the Court of Appeals makes it abundantly clear that there is no conflict, that the decision below is perfectly correct and in accordance with all existing decisions and the best academic thought on the issue involved, and that there is certainly nothing here to warrant review by this Court on certiorari.

1. To the best of our knowledge, all federal courts which have ever considered the question have held uniformly that it is improper to grant security for expenses in a Rule 10b-5 or Rule X-10B-5 action. The Court of Appeals for the Second and Third Circuits, which have given careful thought to the question, are in complete agreement. No decision of this Court, of any circuit, of any district court, has held to the contrary. There is no conflict, there is no semblance of any conflict on the specific point involved or on any other point of any significance here. The decision of the court below is in accordance with the statement of the law on the subject by Professor Louis Loss of Harvard Law School, cited by the Court of Appeals (Pet. 29a-30a) and by Judge Goodrich in the District Court who referred to him as "the foremost authority in the field" (Pet. 2a).

2. The narrow question presented here is, in the language of the Court of Appeals below (Pet. 7a-8a), "whether a shareholder who brings a derivative suit to enforce a corporate cause of action arising under Section 10(b), as implemented by Securities and Exchange Commission Rule 10b-5, and Section 29(b) of the Securities Exchange Act of 1934, may be required to post security for costs, including reasonable attorney's fees." The Court of Appeals answered this question in the negative in accord with the same holding of the Court of Appeals for the Second Circuit in *Fischman v. Raytheon Manufacturing Co.*, 188 F.2d 783, 788-89 (1951), and in accord with the carefully considered opinion of the Second Circuit in *Fielding v. Allen*, 181 F.2d 163 (2d Cir. 1950), *cert. denied* sub nom. *Ogden Corp. v. Fielding*, 340 U.S. 817 (1950), where "the Second Circuit had before it a question almost identical to that with which we are presently concerned" (Pet. 20a). The *Fielding* opinion was written by Circuit Judge Swan for the Court consisting of himself, Chief Judge Learned Hand and Circuit Judge Chase. The *Fischman* opinion was written by Circuit Judge Frank speaking for himself, and Circuit Judges Swan and Chase.

3. The opinion below (Pet. 6a-30a) of the Court of Appeals for the Third Circuit is a classic opinion of persuasive reasoning, clarity and judicial decisiveness. It was written by Chief Judge Biggs for the Court consisting of himself and Circuit Judges Staley and Hastie. Chief Judge Biggs also wrote the opinion for the Third Circuit in *Cohen v. Beneficial Industrial Loan Corp.*, 170 F.2d 44 (3rd Cir., 1948), affirmed by this Court in 337 U.S. 541 (1949), where the New Jersey security-for-costs statute was applied and security was required in a diversity stockholder's derivative action in which the federal court had jurisdiction, as this Court emphasized, "only because the parties are of diverse citizenship." 337 U.S. 541, 543. Judge Biggs, in his opinion below, easily distinguished the *Cohen* decision as being "not in point" in this non-diversity action (Pet. 15a).

4. Though able judges may err, is it not of some significance that the decision below was that of Judges Biggs, Staley and Hastie, that this same decision in the District Court was first reached by Circuit Judge Goodrich sitting there specially, and that this decision is in accordance with the thinking of Chief Judge Learned Hand and Circuit Judges Swan and Chase in the *Fielding* case and of Circuit Judges Frank, Swan and Chase in the *Fischman* case?

5. Even if this Court were otherwise inclined to grant certiorari because of the question raised under Section 10(b) and Rule 10b-5, it is highly doubtful that it would want to grant certiorari in a case such as this where respondents are suing not only under that statutory provision and rule but also under Section 29(b) of the Securities Exchange Act of 1934, and in a case such as this which is not only a stockholders' derivative action but also an action in which the respondents are suing in their own individual right and in a representative capacity on behalf of their class, all other stockholders similarly situated. Even if this Court were to disagree with the court below and were to

conclude that a security-for-expenses provision should be implied from Section 10(b) and Rule 10b-5 along with the private right of action which has been implied in connection therewith, not even the petitioners contend that security for expenses can be required in an action under Section 29(b), which grants an express right of action (Pet. 30a) and which specifically includes a statute of limitations but not a security provision. See supra pages 4-5. Moreover, it is clear that there is no basis on which and no contention that respondents could be required to post any security for expenses in connection with their suit herein as stockholders in their individual capacities and own right and in their representative class action. The complaint alleges direct causes of action on the same facts which the respondents and their class have under Section 10(b), Rule 10b-5 and Section 29(b) against the petitioners wholly apart from the causes of action which basically belong to Borne Chemical Company, Inc. and which respondents are asserting as secondary rights in the derivative part of this action. *Thus, even if this Court were to reverse the court below and were to require the respondents to post security in connection with the derivative phase of this suit, the respondents could, if they chose, then eliminate the derivative aspects of their suit and proceed with this action on the same allegations asserting their own extensive causes of action and those of all other stockholders similarly situated arising out of the same facts all without any need to post security.* Will this Court grant certiorari on the limited issue presented here under such circumstances where its decision is likely to have such a limited effect upon the course of this private litigation?

6. The court below rejected the possibility that a security provision could be implied in Section 10(b) and Rule 10b-5 on analogy to and borrowing from those sections of the Securities Exchange Act of 1934 and of the Securities Act of 1933 which do provide for the imposition of security for expenses (Pet. 27a-30a). Though petitioners

take some slight exception to this ruling (Pet. 16-17), their principal contention is that the New Jersey or Pennsylvania security-for-expenses statute should be applied here. In this connection it is both interesting and noteworthy that petitioners have had some difficulty in this proceeding in trying to determine whether they should rely upon the statute of Pennsylvania, the forum, or of New Jersey, the State of incorporation and principal place of business. In the District Court, as their motions (App. 39a-40a) and the District Court's opinion (Pet. 1a-3a) indicate, petitioners relied only upon the Pennsylvania statute. In the Court of Appeals the petitioners relied almost completely upon the Pennsylvania statute mentioning only in a footnote that "it is arguable that since New Jersey law determines whether directors violated their fiduciary duty in not bringing the suit, perhaps the New Jersey statute on security for costs, including counsel fees, is the applicable statute" (Brief for Appellants, p. 18, n. 5.). In their petition for certiorari it is the New Jersey statute which the petitioners emphasize, even though their motions for security did not even mention the New Jersey statute. In this connection it will be noted that the Court of Appeals summarily dismissed the Pennsylvania statute as "clearly inapplicable" (Pet. 15a) but stated that "the question whether the New Jersey security-for-expenses statute applies poses a subtler problem" (Pet. 17a), concluding that the New Jersey statute is also inapplicable. In any event, neither the Pennsylvania nor New Jersey security-for-expenses statute is applicable in this action for the reasons articulated by the court below and noted *infra*. Just as the Second Circuit held in the leading case of *Fielding v. Allen*, 181 F.2d 163 (2d Cir., 1950), *cert. denied* sub nom. *Ogden Corp. v. Fielding*, 340 U.S. 817 (1950), where the question involved was "almost identical to that with which we are presently concerned" (Pet. 20a), so here the cause of action alleged by respondents on behalf of the corporation is "federally-based", the stockholder's right to maintain a derivative action on a corporate right federal in nature is "federally

conferred", the stockholder's right is "itself federal in nature" and it is therefore "not subject to special requirements for cognate actions under the state law", particularly the New Jersey or Pennsylvania security-for-costs statute.

7. In addition to the fact that the stockholders' derivative suit here is *not* a diversity action where a state security-for-expenses statute would be applied under the rule of the *Cohen* case, it should be noted that this is an action under Section 27 of the Securities Exchange Act of 1934 which gives the federal district courts *exclusive* jurisdiction and not merely concurrent jurisdiction over this action. Certainly this is so much the more reason for disregarding the state security-for-expenses statutes, which only a small minority of the states have enacted and which vary in their provisions, in favor of a uniform federal policy on the subject in these Rule 10b-5 cases over which federal courts have exclusive jurisdiction.

8. The petition for certiorari emphasizes repeatedly that Section 10(b) of the Securities Exchange Act is a "*criminal*" statute. Whatever connotation this is intended to have, we think it more proper merely to note that Section 10(b) makes certain acts, practices and conduct "unlawful"; and that a private right of action, though not expressly given by Section 10(b) or Rule 10b-5, has been implied thereunder on the basis of the *Kardon* doctrine.[1] Whether or not the *Kardon* doctrine is correct and whether or not the respondents have, or have properly alleged, private causes of action under Rule 10b-5 are not at issue at this time.

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[1] *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946).

I. The Decision Below Is Clearly Correct

The magnificent opinion written by Chief Judge Biggs in the court below (Pet. 7a-30a) reflects a very careful consideration by the Court of Appeals for the Third Circuit of all arguments presented by the petitioners and of other questions which the Court of Appeals considered.

First, the Court pointed out that "the derivative suit has been the principal defense of the minority shareholder against abuses by the majority"; that equity has provided shareholders with the device of a derivative suit and has also itself imposed many limitations on the use of this device to protect against certain dangers of abuse inherent in its use (Pet. 10a-11a). Despite these safeguards imposed by equity itself, a small minority of the states have seen fit to enact security for expenses statutes applicable to stockholder derivative suits, but these statutes are not uniform in their provisions (Pet. 11a-13a). "From their inception security for expenses statutes have been the subject of heated controversy" (Pet. 13a). But "there is one proposition about which there is no controversy. A security for expenses statute poses a very serious obstacle to those shareholders to whom it applies who desire to maintain derivative suits" (Pet. 15a).

In dismissing petitioners' argument that the Pennsylvania security statute is applicable here, the Court of Appeals was obviously correct in stating as follows (Pet. 15a): "The Pennsylvania security for costs statute is clearly inapplicable even though this action was commenced in a federal court sitting in that State. In *Erie R. R. v. Tompkins*, 304 U.S. 64 (1938), it was held that the substantive rules of law of the state in which a federal court sits are the rules of decision applicable in diversity actions brought in that court. That security for expenses statutes are 'substantive' law as that term was used in the *Erie* decision was decided in *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541 (1949). In the present case, however, we are not concerned with a cause of action in which federal juris-

diction depends on diversity of citizenship, but with a case arising under a federal statute which itself confers jurisdiction upon the federal district courts. See Section 27(a) of the Act, 15 U.S.C.A. §78aa. The *Erie* doctrine and the holding in the *Cohen* case are, therefore, not in point. See *Rothenberg v. H. Rothstein & Sons*, 183 F. 2d 524, 528 (3 Cir. 1950)."

The Court below properly rejected petitioners' argument that the Pennsylvania statute should be applied in the present case (where there is no provision in Section 10(b), Rule 10b-5 or Section 29(b) authorizing a court to require security) on analogy to the doctrine whereby local statutes of limitations are applied in cases arising under federal statutes which contain no provisions for limitations of action. The Court concluded that "the reasoning underlying that doctrine renders it inapposite in the case of a security for expenses statute" (Pet. 16a). True enough, local limitation statutes are applied in actions at law under federal statutes where Congress is silent on the subject because these statutes of limitations embody a "cardinal principle of modern law" to which, it should be presumed, Congress intended to subject rights of action which it has created (Pet. 16a). There is a "presumed congressional intent to have courts judicially imply a limitation provision" and this presumption "is justified by the fundamental and universal nature of the concept of limitation and the improbability of Congress having intended to create a right not subject to a limitation period" (Pet. 16a-17a).

However, as Judge Biggs stated very persuasively (Pet. 17a), "In the present case we are not dealing with congressional silence on limitations but silence on security for expenses. Unlike statutes of limitations, security statutes do not embody traditional principles of law which are universally accepted. There is sharp dispute as to their desirability and efficacy. Moreover, only a minority of our states have enacted such statutes. Under these cir-

cumstances a presumption that Congress intended that courts should imply a security requirement from a statute, granting an express or an implied private right of action seems unjustified. *Congress cannot be presumed to have authorized the courts to engraft a unique and controversial limitation upon a statutory right through its silence on the subject of that limitation.*" (Emphasis added.)

With respect to the applicability here of the New Jersey security for expenses statute, the court below carefully considered the "subtler problem" posed by the fact that New Jersey is the State of incorporation of petitioner Borne and the place of its principal office (Pet. 17a-18a). "As such New Jersey has a clear interest in the relationships between the stockholders and the management of the corporation" (Pet. 18a). When New Jersey enacted its statute, it made "a far-reaching and fundamental alteration of existing stockholders-management relationships" and "the right of a shareholder of a New Jersey corporation to bring a derivative suit was severely limited" (Pet. 18a). The question is: "Should this limitation be adhered to by a federal court when the corporate right that the plaintiff seeks to enforce derivatively arises under federal law?" (Pet. 18a).

In answering this question in the negative, the Court of Appeals stated that it did "not believe that Sections 10(b) and 29(b) of the Securities Exchange Act should be construed as being superimposed upon the stockholder-management relationship defined by state security for expenses statutes, since the federal provisions are a part of a statutory scheme which had as its purpose the creation of a new federal law of management-stockholder relations and which, therefore, may not be subordinated to limitations such as security for expenses statutes, reflecting state policy in the same area. It is true that federal law often depends upon state-created legal relationships. Admittedly, where, precedent to the enforcement of a federal right, a question arises on the resolution of which Congress has

been silent, state law will be controlling in many instances. But state law will only control where that law will not cut across the federal interests receiving expression in the federal right sought to be enforced. . . . In the present case we are construing two sections of the Securities Exchange Act of 1934. That Act deals with the protection of investors, primarily stockholders. It creates many managerial duties and liabilities unknown to the common law. It expresses federal interest in management-stockholder relationships which theretofore had been almost exclusively the concern of the states. Section 10(b) imposes broad fiduciary duties on management vis-a-vis the corporation and its individual stockholders. As implemented by Rule 10b-5 and Section 29(b), Section 10(b) provides stockholders with a potent weapon for enforcement of many fiduciary duties. It can be said fairly that the Exchange Act, of which Sections 10(b) and 29(b) are parts, constitutes far reaching federal substantive corporation law. . . ." (Pet. 23a-24a).

Judge Biggs pointed out that "state security for expenses statutes are more than procedural modifications. They are, rather, fundamental regulations of the management-shareholder relationship. As such they cut across a similar federal interest embodied in the Securities Acts. If held to be applicable in actions under Section 10(b) they would limit severely the scope of that section in an area comprehended by the statutory scheme. Where a unique and controversial state doctrine alters relationships that are the principal concern of a federal statute that doctrine will not be applied to limit rights arising under the federal statute. Thus state interest in the present suit must be subordinated to the federal policy occupying the same field. . . ." (Pet. 24a-25a).

Judge Biggs quoted at length and with approval from the opinion of the Court of Appeals for the Second Circuit in *Fielding v. Allen*, 181 F.2d 163, *cert. denied* sub nom. *Ogden Corp. v. Fielding*, 340 U.S. 817 (1950) where it

was held that "the stockholder's right to maintain a derivative action on a corporate right federal in nature is federally conferred" by federal equity law and that in non-diversity cases this federal equity right of a stockholder should be available without reference to the peculiar requirements of local law (Pet. 19a-22a). In the *Fielding* case, the Second Circuit refused to apply the New York security for expenses statute to require the plaintiffs in a stockholder derivative action under the federal Transportation Act of 1920 to post security for expenses. The Court below stated:

"We agree with the result reached by the Second Circuit in the *Fielding* case and with its reasoning that in a case such as that at bar the policy of uniformity within the federal system is stronger than any policy of conformity with local rules. As we have pointed out only a minority of states have adopted security statutes and the statutes differ from one another. There is much to be said for the argument that a federal right, uniform in its nature throughout the nation, should be uniformly enforceable pursuant to federal standards. That Congress intended uniform enforcement of rights arising under The Securities Exchange Act of 1934 is indicated strongly by the fact that it gave exclusive jurisdiction to the United States courts of any suit brought to enforce the duties or liabilities created by the Act. See Section 27 of the Act, 15 U.S.C.A. §78aa." (Pet. 22a).

The Court of Appeals rejected the suggestion by petitioners that security for expenses may be required under "general federal equity law" (Pet. 25a-26a). The Court of Appeals also rejected the contention of petitioners that, since a private right of action is implied rather than explicitly granted by Section 10(b) and Rule 10b-5, a security for expenses limitation should be implied along with the implied private remedy because the Securities Exchange Act does contain security provisions in certain other sections. The Court stated: "This argument is, of course, ten-

able only where the statute evinces a clear policy in favor of security for expenses limitations. Even then, we believe, there would be a serious question whether a court, in the proper exercise of its judicial function, could carry the traditional tort doctrine of implication of private remedies to such a length. With respect to Section 10(b) and Rule 10b-5, however, we do not have to deal with the extent to which we can impose limitations on private rights of action implied from statutes because we have concluded that the Securities Acts do not evince a sufficiently clear or uniform policy in favor of security for expenses provisions to justify the imposition of such a limitation on the private right of action which has been implied from Section 10(b)." (Pet. 27a-28a).

The Court below reviewed the different security provisions in the Securities Act of 1933 and the Securities Exchange Act of 1934 (Pet. 28a-29a); noted that these provisions varied; and pointed out that only Section 9(e) and Section 18(a) of the Securities Exchange Act of 1934 (15 U.S.C. §§78i, 78r) contain security for expenses provisions in connection with private actions under those sections. Even there it is discretionary and not mandatory for the court to require the posting of security. On the other hand, as the Court of Appeals emphasized, "Section 16(b) of the Exchange Act, 15 U.S.C.A. §78p, which grants rights of action to shareholders injured by 'insider-trading', has no security for expenses requirement. Similarly, Section 29(b) of the Act, pursuant to which this action is brought in part, does not contain a security requirement." (Pet. 29a). Accordingly, the Court below properly concluded that "It is apparent that the Acts do not manifest sufficiently clear or uniform policy favoring security for expenses to allow us to imply such a limitation from Section 10(b). Were we to attempt to do so we would have to discover some reason for following the course Congress took with respect to the Securities Act and Sections 9(e) and 18(a) of the Exchange Act rather than that exemplified by Sec-

tion 16(b). But there seems no rational basis for concluding that the right of action implied from Section 10(b) bears a greater similarity to the sections limited by security requirements than it does to Section 16(b) which is unencumbered by that requirement. Indeed, a persuasive argument could be made that the plaintiffs' complaint in the present case, alleging as it does fraudulent dealings by insiders to the detriment of stockholders, sounds as much in Section 16(b) as in any other liability section contained in the Acts. Moreover, even if we decided against the analogy to 16(b), we would be faced with the impossibility of making a rational choice between the provision contained in Section 11(e) on the one hand and Sections 9(e) and 18(a) on the other. For these reasons we decline to imply a security for expenses requirement from Section 10(b) or Rule 10b-5." (Pet. 29a-30a).

II. The Decision Below Does Not Conflict With Any Decisions of This Court or With Any Other Circuit Court Decisions.

There is obviously no merit to petitioners' contention (Pet. 17) that the decision of the Court below is in "direct conflict" with the recent decision of the Court of Appeals for the Seventh Circuit in *Bankers Life and Casualty Co. v. Bellanca Corporation*, 288 F.2d 784 (7th Cir., 1961), *cert. denied* —— U.S. —— (Oct. 9, 1961). There is not the slightest conflict here. In the *Bellanca* case the Seventh Circuit held that Section 29(b) of the Securities Exchange Act only voided the contract rights of the party who was in violation of the Act and did not relieve the party who was not in violation from paying for consideration which the non-violator had actually received from the violator. Since Section 29(b) was not intended to give the non-violator this particular relief, the rights of the non-violator in this respect are to be measured by the law of the state involved. We fail to see the relevance of the *Bellanca* case. And we

might note, there was not a word in the *Bellanca* opinion that warranted the assertion in the petition (17) that the court held there that federal courts should "not attempt to fashion a uniform federal rule". But this inaccuracy in the petition is nothing compared with petitioners' *fantastic* statement on the same page of the petition that "The court below has held that in dealing with the Securities Exchange Act, a federal court fashions its own federal common law and rejects the law of the state of incorporation and the forum in determining those parts of the cause of action which are not expressly or impliedly spelled out in such federal statute"! (Pet. 17)

Petitioners do not allege that there is any direct conflict between the decision below and any decision of this Court. Indeed, there has been no decision of this Court on the question raised in this petition or on any related Rule 10b-5 matter. However, petitioners do contend that "The decision below conflicts with the applicable decisions of this Court dealing with the law to be applied to determine corporate shareholders' rights inter sese and remedies where the federal statute is absolutely silent on the subject" (Pet. 10). A bare reading of this portion of the petition (Pet. 10-17) and, of course, a reading of the decisions of this Court there cited, makes it very clear that petitioners are in error, that there certainly is no direct conflict, that there is no real conflict on the same matter of law or fact, and that there is not even a true inconsistency in dicta or in the general principles utilized.

We must vigorously dispute the statement of petitioners (Pet. 10) that this Court repeatedly has held "in situations similar to the one presented herein" that a federal court should apply State law, even in a suit to enforce express civil provisions of a federal statute where the precise issue is not expressly covered by the federal statute conferring the basic right. In support of this statement the petitioners cite *De Sylva v. Ballentine*, 351 U. S. 570, 580 (1956); *O'Sullivan v. Felix*, 233 U. S. 318 (1914);

and *Campbell v. City of Haverhill*, 155 U. S. 610 (1895). There is clearly no conflict with any of these decisions. They did not involve similar situations. The *De Sylva* and *Campbell* decisions were easily distinguished by the Court below. See Pet. 16a, 23a.

In *De Sylva* the issue was whether illegitimate children were "children" within the meaning of the Copyright Act. This Court looked to state domestic relations law for the answer, reasoning, in part, as follows: "The scope of a federal right is, of course, a federal question, but that does not mean that its content is not to be determined by state, rather than federal law. . . . This is especially true where a statute deals with a familial relationship; there is no federal law of domestic relations, which is primarily a matter of state concern . . ." 351 U. S. 570, 580. However, as the Court below pointed out, "In the present case there is a comprehensive body of federal law with respect to the bringing of derivative suits. Indeed, the derivative suit, and the limitations upon its use, were initially developed in the federal courts. . . . There is, therefore, no compulsion in the present case to adopt state law because it is the only developed body of law pursuant to which this federal right may be enforced." (Pet. 23a).

The *Campbell* and *O'Sullivan* cases, *supra*, were statute of limitations cases. So was *Hooper v. Mountain States Securities Corporation*, 282 F. 2d 195, 205 (5th Cir., 1960), *cert. denied* 5 L. Ed. 2d 693 (1961), upon which petitioners rely (Pet. 11). So also *Tobacco and Allied Stocks v. Transamerica Corp.*, 143 F. Supp. 323 (D. Del. 1956), *affirmed*, 244 F. 2d 902 (3rd Cir., 1957); *Fratt v. Robinson*, 203 F. 2d 627, 634 (9th Cir. 1953); and *Gordon v. Loew's, Inc.*, 247 F. 2d 451, 454 (3rd Cir., 1957)—all cited by petitioners (Pet. 11, n. 8). The opinion of the Court below carefully and persuasively distinguished the present security for expense statute case from the statute of limitation cases. See Pet. 15a-17a and *supra* pages 19-20. We have no conflict of decision here.

What was said by this Court in *Board of County Commissoners v. United States*, 308 U. S. 343 (1939), an Indian treaty case cited by petitioners (Pet. 13), is entirely consistent with the decision of the Court below. See Pet. 19a, 24a.

Though petitioners quote extensively from *Cohen v. Beneficial Industrial Loan Corporation*, 337 U. S. 541 (1949) (Pet. 12-14), we think they concede that the Court below correctly ruled (Pet. 15a) that the holding in the *Cohen* case is "not in point" here because that was a diversity case and this is a non-diversity case. With respect to the language quoted by petitioners from the *Cohen* case, the Court below quoted the same language in discussing and then dismissing the possibility that the security statute of New Jersey, the State of incorporation, might be applicable here. See Pet. 18a. The inapplicability of the *Cohen* decision to non-diversity cases involving federal rights is now well established. *Fielding v. Allen*, 181 F. 2d 163 (2d Cir., 1950), *cert. denied* sub nom. *Ogden Corp. v. Fielding*, 340 U. S. 817 (1950). See *Le Bouef v. Austrian*, 240 F. 2d 546, 551 (4th Cir., 1957); *Breswick & Co. v. Briggs*, 136 F. Supp. 301, 302 (S. D. N. Y. 1955); *Hoover v. Allen*, 180 F. Supp. 263, 267 (S. D. N. Y. 1960). See 3 Loss, *Securities Regulation* (2d ed. 1961) 1839 note 512.

Not only is the decision of the Court below not in conflict with any other decisions, but it is in accord with clearly established law that security for costs cannot be required in a federal court action based upon violation of Section 10(b) of the Securities Exchange Act and of Rule 10b-5 adopted thereunder. ALL FEDERAL COURTS WHICH HAVE EVER CONSIDERED THE QUESTION HAVE HELD, WE BELIEVE, THAT IT IS IMPROPER TO REQUIRE SECURITY FOR COSTS, INCLUDING ATTORNEYS' FEES, IN A RULE 10b-5 OR RULE X-10B-5 ACTION. *Fischman v. Raytheon Manufacturing Company*, 188 F. 2d 783 (2d Cir., 1951); *Stella v. Kaiser*, 81 F. Supp. 807 (S. D. N. Y. 1948); *McManus v.*

The Jessup & Moore Paper Company, et al., Civil Action No. 8015, E. D. Pa. (Order of Judge Bard, entered December 22, 1949, denying, without opinion, motion of defendants to require plaintiffs to give security for defendants' expenses and attorneys' fees); *Acker v. Schulte*, 74 F. Supp. 683, 690 (S. D. N. Y. 1947). See 3 Loss, *Securities Regulation* (2d ed. 1961) 1780, 1836-1842, 1839 note 512, 1842; 6 *Moore's Federal Practice* (1953) 1331 note 40; Note, *Security for Expenses Legislation—Summary, Analysis and Critique*, 52 Col. L. Rev. 267, 275 (1952). The decision of the District Court (Pet. 1a-5a) in the present case is cited with approval by Professor Loss in the new second edition of his treatise, *supra*, at page 1837 notes 503 and 506.

III. Certiorari Should Be Denied

Every interesting question of law has some "public importance", but this certainly is not enough to warrant review by this Court on certiorari. The point involved in this particular private law suit is a rather narrow one. Defendants have made much of it and, as a consequence, it has received the careful consideration and decision of the District Court and the Court of Appeals for the Third Circuit. What they have said in their opinions has been limited to the very limited question raised. But petitioners see great "public importance" in all this (Pet. 18-19). They generalize on the decision below. They see sinister consequences in it. They cry an alarm for certiorari.

It is ironical how petitioners' motions for security for expenses have delayed this proceeding—including all discovery—for almost two years. Respondents commenced this action on December 19, 1959, alleging fraudulent conduct on the part of the corporate insiders and seeking full equitable relief including discovery. On February 9, 1960, some of the petitioners filed motions for security for costs including counsel fees together with motions to dismiss.

The motions to dismiss have been held in abeyance pending the outcome of the motions for security. No answers have been filed to date. On February 9, 1960, the petitioners also notified the respondents of an intention to take their depositions on March 2, 1960. On February 10, 1960, the respondents notified the petitioners that respondents would be available for depositions on the date fixed and that respondents would take the depositions of some of the petitioners and others on March 3, 1960.

Petitioners have shown no interest at any time in proceeding with the depositions of respondents. Moreover, petitioners sought and secured from the District Court a protective order directing the plaintiff respondents to delay taking depositions "until after the motion for posting security is determined." As a result, respondents have not been able to secure any discovery in this action up to the present time. Hopefully, certiorari will be denied and plaintiffs will be able to proceed—after almost two years.

The purpose of seeking security for expenses is to secure a bond for such expenses *before* the corporation is compelled to spend very much in counsel fees and other litigation expenses. In this case, however, the able attorneys for petitioners have devoted already a large amount of time and effort (presumably at substantial expense to petitioners) in seeking security for expenses, in appealing an adverse decision thereon, and in seeking review thereof on certiorari.

Conclusion

For the reasons stated above, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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November 22, 1961